ELMWOOD COMMERCIAL RENT STABILIZATION AND EVICTION PROTECTION ORDINANCE

REGULATIONS

CITY OF BERKELEY
BOARD OF ADJUSTMENTS

Adopted: October 11, 1982
Amended:

Resolution No. 82-001

BOARD OF ADJUSTMENT RESOLUTION ADOPTING REGULATIONS IMPLEMENTING ORDINANCE NO. 5468-N.S., THE ELMWOOD COMMERCIAL RENT STABILIZATION AND EVICTION PROTECTION ORDINANCE AND SETTING FILING FEES

WHEREAS, the Board of Adjustments is charged with implementing the provisions of City of Berkeley Ordinance No. 5468-N.S., the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance; and

WHEREAS, the Board of Adjustments may adopt rules and regulations to discharge its responsibilities under the ordinance.

NOW, THEREFORE, Be It Resolved by the Board of Adjustments of the City of Berkeley as follows:

1. The attached regulation sections are hereby adopted as regulations of the Board;

2. A petition filing fee is hereby set at $100 for the first unit and $20 for each additional unit in the same building;

3. The staff is hereby authorized to modify any forms required by the Board, if in its judgment such revisions are appropriate.

ORDINANCE NO. 5468-N.S.

ELMWOOD COMMERCIAL RENT STABILIZATION AND EVICTION PROTECTION ORDINANCE

The people of the City of Berkeley do ordain as follows:

Section 1. Title:

This Ordinance shall be called the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance.

Section 2. Purposes:

The purposes of this Ordinance are to protect commercial tenants in the Elmwood district from rent increases which are not justified by landlord's cost increases; to enable those tenants to continue serving residents of the Elmwood district without undue price increases, expansion of trade (which may exacerbate parking problems), or going out of business; and to test the viability of commercial rent stabilization as a means of preserving businesses which serve the needs of local residents in Berkeley neighborhoods, outside the downtown business district.

Section 3. Scope:

This Ordinance shall apply to all commercial premises (both office and retail), rented or available for rent, only in the Elmwood district of the City of Berkeley. The boundaries of this district are as follows: Stuart Street on the north, Webster Street on the south, Piedmont Avenue on the east, and Benvenue Avenue on the west.

Section 4. Definition:

In this Ordinance, the following words and phrases have the following meanings:

(a) Landlord: Any owner, lessor, sublessor, or other person entitled to receive rent for the use or occupancy of any rental unit, or an agent thereof; provided, however, that the word "landlord" shall not include any governmental agency.

(b) Rent: Any consideration (including any deposit, bonus, or gratuity) demanded or received in connection with the use or occupancy of any rental unit.

(c) Rental unit: Any property, building, structure, or part thereof, or land appurtenant thereto, which is covered by Section 3 of this Ordinance, together with all services connected with the use or occupancy thereof.

(d) Services: Those services and facilities which enhance the use of the rental unit, including but not limited to repairs, replacement, maintenance, painting, heat, hot and cold water, utilities, elevator service, security devices and patrols, furnishings, storage, janitorial and landscaping services, refuse removal, insurance protection, parking spaces, and services to and facilities in common areas of the building or parcel in which the rental unit is located.

(e) Tenant: A tenant, subtenant, lessee, sublessee, or any other person entitled to the use or occupancy of any rental unit.

(f) Consumer Price Index: The All Items Consumer Price Index for All Urban Consumers, San Francisco-Oakland, California, as published by the United States Department of Labor, Bureau of Labor Statistics.

Section 5. Maximum Rent:

(a) No landlord of any rental unit covered by this Ordinance shall request, demand, receive, or retain more than the maximum rent allowed by this section. The maximum rent shall be the "base rent" plus any "allowable adjustments."

(b) "Base rent": Except as provided herein, base rent shall be the lawful periodic rent in effect on October 1, 1981 (the approximate time the current campaign for commercial rent stabilization in the Elmwood district began).

i) If, on October 1, 1981, the rental unit was held under a lease which provided for fixed rental payments of varying amounts (e.g., rents escalating with a Consumer Price Index), then the base rent shall be the amount of the final lawful periodic rental payment required by such lease.

ii) If, on October 1, 1981, the rental unit was held under a lease which provided rental payments whose amounts were determined by gross sales, in whole or in part (whether or not there is a fixed minimum rent), the monthly base rent shall be the total amount of rent lawfully payable for the final 12 months of such lease, divided by 12, unless the landlord notifies the tenant in writing at least 30 days before the lease expires that the landlord chooses to continue the same provisions for determining rent as were provided by such lease. If the landlord so notifies the tenant, then such provisions shall continue, provided, however, (1) that the rent shall not be subject to the "allowable adjustment" allowed by this section, (2) that the landlord may thereafter abandon this method of determining rent and use the other method provided by this subsection ((5)(b)(ii)) to determine the base rent (adding any "allowable adjustments" to determine the "maximum rent"), but only upon 90 days prior written notice to the tenant, and (3) that the landlord must abandon the gross sales method of determining rent and shall use the other method provided by this subsection ((5)(b)(ii)) to determine the base rent (adding any "allowable adjustment to determine the "maximum rent"), if the rental unit fails to sell or produce substantially the same types of goods or services to the community as it did on October 1, 1981.

(iii) If, on the date this Ordinance becomes effective, the rental unit was held under a lease or rental agreement providing for fixed rental payments, and such rent has not been raised in the 12 months prior to that date, then the base rent shall be increased by the percentage of base rent which equals the following amount: 5% times the number of years (rounded off to the nearest year) between the date the rent on the rental unit was last raised (before enactment of this Ordinance) and the date this Ordinance becomes effective.

(iv) The base rent for any rental unit newly constructed after October 1, 1981, or not rented on October 1, 1981, shall be the lawful periodic rent actually charged for the first 12 months after the unit is rented. This method of establishing base rent shall not be allowed, however, if the parcel on which such new unit is built contained, on October 1, 1981, a rental unit covered by this Ordinance, which a newly constructed unit has replaced.

(c) "Allowable adjustments":

(i) The allowable adjustments shall be the unit's proportionate share of increases in periodic costs, to the landlord, since the end of the period used for determining the base rent under subsection (b), or since the last allowable adjustment, whichever is later. Such costs shall include costs of maintenance and operating expenses, property taxes, fees in connection with the operation of the property, and improvements

(amortized over the useful life of each improvement). Increased costs due to increased principal or interest charges on a loan shall not be allowed, however, where such increased charges result from a larger loan being taken on the property (as contrasted with increased charges resulting from increases in prevailing rates of interest), whether due to refinancing by the landlord or purchase financing by a new landlord.

(ii) No allowable adjustment shall be based on increased costs incurred with the intent to evade any of the purposes of this Ordinance.

(iii) The allowable adjustment shall not include an increase in any cost which the tenant is already required to pay by the terms of the lease on the rental unit (such as property taxes and insurance).

(iv) Allowable adjustments shall become effective only if the landlord gives the tenant at least 30 days prior written notice that the landlord is imposing the adjustment and thereby raising the rent. Such notice shall be served according to the provisions of Code of Civil Procedure section 1162 or by any reasonable manner agreed upon by the parties. The notice must specify the base rent, the costs which have risen, including the amortization period used for any improvements, their amounts and the method of apportionment among units. The notice must advise the tenant that, upon the tenant's request within 10 days, the landlord will furnish documentary evidence of the base rent and increased costs. If such request is made, the landlord shall furnish such documentary evidence within 10 days after such request. If the landlord fails to furnish such evidence within 10 days, the notice of allowable adjustment shall become null and void. The tenant's failure to request such evidence shall not be deemed a waiver of his right to later contest the validity of the rent increase.

(d) If a rental unit is hereafter subdivided into 2 or more rental units, then the base rents of the new units shall be determined by apportioning the base rent of the old unit and any allowable adjustments among the new rental units according to the square footage of each unit. If two or more rental units are hereafter consolidated into one rental unit, then the base rent on the new unit shall be the total of the base rents and any allowable adjustments on the former units.

Section 6. Extraordinary Rent Increase:

(a) If the application of this Ordinance, or any section or part thereof, would operate to violate the United States or California Constitution by denying a landlord a fair and reasonable return on investment or by confiscating the landlord's property, then such Ordinance, section, or part thereof shall apply to such landlord only to the extent that it does not deny him a fair and reasonable return on investment or confiscate his property.

(b) If a landlord believes a rent greater than is allowed by Section 5 is necessary to provide him with a fair and reasonable return on investment, such landlord shall petition for and obtain a declaration from the Board of Adjustments that such rent is permitted by this section, before increasing rent pursuant to this section.

(c) The Board of Adjustments shall enact regulations relating to its duties under this Section, including the definition of "fair and reasonable return on investment."

Section 7. Services, Lease Provisions, and Assignments:

(a) No landlord shall reduce or eliminate any service to any rental unit covered by this Ordinance, unless a proportionate share of the cost savings due to such reduction or elimination is passed on to the tenant in the form of a decrease in rent. Nor shall any landlord delete or modify any provision of any existing or proposed lease or rental agreement to the disadvantage of a tenant, unless the fair value of such deletion or modification is passed on to the tenant in the form of a decrease in rent.

(b) No lease entered into after the effective date of this Ordinance may contain any provision prohibiting or limiting the tenant's right to assign the lease to a purchaser of the tenant's business, except that a lease provision may condition such assignment on the purchaser being at least as capable of complying with the lease as the tenant, and a lease provision may condition such assignment on the payment to the landlord of any necessary and reasonable expenses caused the landlord by the assignment. No other payment to the landlord shall be required or made for his consent to the assignment. Any consideration paid to the tenant, directly or indirectly, for the transfer (by assignment, sublease, or otherwise) of any lease or sublease of any rental unit or part thereof shall be treated as part of the rent for the first month of occupancy after the transfer and, as such, shall be subject to the limitations on rent imposed by this Ordinance.

Section 8. Dispute Resolution:

(a) In case of any dispute over the meaning or application of any provision of this Ordinance (except Section 9), a landlord, tenant, or any other interested party or neighborhood organization may petition the Board of Adjustments for resolution of the dispute. Where the City Attorney determines that the City of Berkeley or any neighborhood thereof is an interested party, the City Attorney may petition or otherwise appear on behalf of such party.

(b) Within a reasonable time after the effective date of this Ordinance, the Board of Adjustments shall adopt rules and regulations designed to assure prompt and fair resolution of disputes which may arise under this Ordinance. Such rules and regulations shall include provisions assuring that timely notices of petitions and hearings shall be given to all affected parties. Such rules and regulations may include a schedule of reasonable fees to cover the cost of dispute resolution, and may indicate which party shall be responsible for such fees. The Board of Adjustments may thereafter amend, repeal, and supplement its rules and regulations as it deems appropriate to assure prompt and fair resolution of disputes.

(c) The Board of Adjustments may delegate its powers to hold hearings and render decisions under this section to groups of one or more members of the Board, or to hearing officers, with or without the right to appeal to the full Board, if such delegation will help to assure prompt and fair resolution of disputes.

(d) In any case in which the validity of any proposed or actual rent increase under the Ordinance is in dispute, the burden of proof shall be on the landlord to establish all facts which show that the rent increase is allowed by this Ordinance.

(e) The Board of Adjustments may issue orders to enforce its regulations and decisions.

(f) The decision of the Board of Adjustments shall be final, subject to the right of any party to seek judicial review in any court of competent jurisdiction. Such review may be sought by any affected landlord, tenant, the City of Berkeley, or any interested party or neighborhood organization, whether or not such party participated in the Board of Adjustments proceedings.

(g) The Board of Adjustments may, from time to time as it deems appropriate, adopt regulations which interpret various provisions of this Ordinance.

(h) If the Board of Adjustments becomes aware that any purpose of this Ordinance is being evaded or that it is not operating fairly toward landlords, tenants, or the community, the Board shall promptly notify the City Council and may recommend that appropriate amendments to this Ordinance be placed on the ballot.

(i) The Board of Adjustments shall have the powers and duties necessary to fulfill the purposes of this Ordinance.

Section 9. Evictions:

In any action to evict any tenant from any rental unit covered by this Ordinance, the landlord shall plead and prove that the landlord is in compliance with Section 5(a) of this Ordinance, and that the action is being brought for one or more of the following reasons, which were stated in the notice of termination:

(a) the tenant has failed to pay the lawful rent to which the landlord is entitled, and failed to comply with a valid notice to pay or quit served pursuant to Code of Civil Procedure section 1161;

(b) the tenant has substantially violated an obligation imposed by the lease or rental agreement (other than an obligation to surrender possession at the end of a term or upon notice) and has failed to cure such violation within 10 days after having received written notice thereof from the landlord;

(c) the tenant is committing or permitting to exist a nuisance in the building or parcel, or is causing a substantial interference with the comfort, safety or enjoyment of the building or parcel by the landlord or other tenants;

(d) the tenant is using the rental unit for some illegal purpose;

(e) the tenant, who had a lease or rental agreement whose term has expired, has refused (after receiving a request in writing) to execute a written extension or renewal thereof for a further term of like duration, containing provisions which are not inconsistent with this Ordinance and are materially the same as those in the previous lease or rental agreement;

(f) the tenant has refused to allow the landlord reasonable access to the premises to make necessary repairs or improvements, or to show the rental unit to a prospective purchaser, mortgagee, or tenant;

(g) the landlord in good faith seeks to recover possession in order to remove the rental unit from commercial use, after having obtained all the necessary permits to do so; provided, however, that if the landlord evicts for this reason and, within one year thereafter, the rental unit is being used for any commercial use, it shall be presumed that the landlord's stated purpose in evicting was false, in any action by the tenant against the landlord for abuse of process or malicious prosecution of a civil action;

(h) the landlord in good faith seeks to recover possession in order to repair code violations or improve the premises, after all necessary permits have been obtained, if it is not feasible to perform such repairs or improvements while the tenant remains in possession; provided, however, that when the repairs or improvements are completed, the landlord shall so notify the tenant and allow the tenant 30 days in which to decide whether or not to return to the premises.

Section 10. Retaliation:

No landlord shall in any way retaliate against any tenant for the tenant's assertion or exercise of any right under this Ordinance. Such retaliation shall be a defense in any action to evict the tenant and shall be subject to suit for actual and punitive damages, injunctive relief, and attorney's fees. The tenant need not exhaust any remedy before the Board of Adjustments prior to raising such defense or filing such suit. In any action wherein such retaliation is at issue, where the action was filed within 6 months of the tenant's assertion or exercise of rights, the burden shall be on the landlord to prove that the dominant motive for the act alleged to be retaliatory was some motive other than retaliation.

Section 11. Remedies:

(a) If a landlord attempts to increase rent under Section 5(c), and any of the information in the notice of rent increase or supporting documentary evidence is false, inaccurate, misleading, or incomplete in any material way, then the notice of rent increase shall be null and void. If, in addition, it is proved that the landlord acted knowingly and willfully in providing such false, inaccurate, misleading or incomplete information or evidence, then the landlord shall pay the tenant, as a penalty, three times the amount of rent demanded in the notice of rent increase.

(b) Any affected tenant shall recover actual damages whenever the landlord receives or retains any rent in excess of the maximum amount allowed under this Ordinance, and whenever the landlord violates any eviction provision of this Ordinance. If, in addition, it is proved that such act was in bad faith, the landlord shall pay the tenant, as a penalty, three times the actual damages.

(c) If a tenant fails to bring a civil or administrative action within 120 days of any violation of this Ordinance, then such action may be brought on the tenant's behalf by the City of Berkeley or any interested party or neighborhood organization, which shall retain one-half of any amount awarded in such action or received in settlement of such action.

(d) No exhaustion of the administrative remedies provided in section 8 shall be required as a precondition to invoking any remedy provided by this section.

(e) In any action wherein any party succeeds in obtaining any remedy, in whole or in part, under this section, such party shall be awarded reasonable attorney's fees. If a party asserts a remedy under this section and fails to obtain any relief whatsoever, then the prevailing party shall be awarded reasonable attorney's fees.

Section 12. Waiver:

No provision in any lease, rental agreement, or agreement made in connection therewith, which waives or diminishes any right of the tenant under this Ordinance, is valid.

Section 13. Application to Pre-existing Leases:

(a) This Ordinance shall not operate to change any provision in any fixed-term (as opposed to month-to-month) lease executed before October 1, 1981, and in effect on the date this Ordinance is enacted. Whenever such a lease expires, however, this Ordinance shall thereupon apply to the affected rental unit; provided, however, that if such lease is renewable at the landlord's or tenant's option, and such option is exercised, this Ordinance shall not apply to the rental unit until the renewed lease expires.

(b) Notwithstanding the provisions of subsection (a) above, any lease in effect on the date this Ordinance is enacted, which lease was executed since one year prior to October 1, 1981, which increased the rent over the prior rent by more than the increase in the Consumer Price Index from the date the prior rent became operative to the date such lease was executed, shall have its rent reduced immediately to the prior rent, plus such increase in the Consumer Price Index. The purpose of this subsection is to preserve certain businesses which have recently received such high rent increases that they would—but for this subsection—find it necessary to take steps contrary to the purposes of this Ordinance, as set out in Section 2. This subsection shall not operate to deprive any landlord of a fair return on investment.

Section 14. Partial Invalidity:

If any provision of this Ordinance or any application thereof is held invalid, such invalidity shall not affect any other provision or application of this Ordinance which can be given effect without the invalid provision or application, and to this end the provisions of this Ordinance are declared to be severable.

Section 15. Effective Date:

This Ordinance shall become effective on the date it is enacted.

ADOPTED REGULATIONS

INDEX OF REGULATIONS

Section 151 - Manner of Service

All papers which are required by these regulations to be served shall either be personally delivered or sent by certified mail.

Section 152 - Calculation of Time - Service by Mail

For purposes of calculating the time periods specified in the ordinance and implementing regulations, notices served by certified mail shall be deemed served five days after the date they were mailed.

400 - Definitions - Same as those in Ordinance

Unless otherwise specified, in a specific regulation, or further defined in this chapter the terms used in regulations implementing the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance shall have the meaning set forth in Section 4 of that ordinance.

401 - "Board"

The word "Board" used in these regulations shall mean the Board of Adjustments of the City of Berkeley and the Commercial Rent Stabilization office of the Board.

402 - "Ordinance"

The word "Ordinance" used in these regulations shall mean the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance.

Section 530 - Maintenance and Operating Expenses

(a) Maintenance and operating expenses shall include all expenses incurred reasonably and in good faith for maintaining and operating the rental unit for which the adjustment in rent is sought, except as provided in subdivision (b) below.

(b) Maintenance and operating expenses shall not include the following:

(1) mortgage principal or interest charges on a loan where such increased charges result from a larger loan being taken on the property (as contrasted with increased charges resulting from increases in prevailing rates of interest), whether due to re-financing by the landlord or purchase financing by a new landlord;

(2) any penalties, fees, damages, or interest assessed or awarded for violation of the Ordinance or these regulations;

(3) legal, accounting or filing fees or other costs incurred in connection with any Board of Adjustments proceeding or any court action brought pursuant to the ordinance, except as provided in Section 858;

(4) organization or association dues or fees;

(5) legal or other costs for any evictions;

(6) depreciation of the property;

(7) expenses for which the landlord has been reimbursed by any security deposit, insurance settlement, judgment for

damages, agreed upon payments, or any other method.

(c) Any non-recurring expense shall be amortized over a reasonable period of time, to allow the expense to be recovered during that period.

Section 531 - Capital Improvements

a) Purpose. The purpose of this Section is to ensure that the costs of capital improvements are amortized over a reasonable period of time and are paid for by all tenants who benefit from them.

b) Capital Improvement. A capital improvement shall be any improvement to a unit or property which has a useful life of more than one year and a direct cost of $250 or more per unit affected.

c) Policy. The rent ceilings for a unit or property may be adjusted to reflect the amortized cost of planned or completed capital improvements to the unit or property:

(1) where such capital improvements are necessary to bring the unit or property into compliance or maintain compliance with applicable local code requirements affecting health and safety, or the integrity of the structure provided that in determining the cost of a capital improvement no consideration shall be given to any additional cost incurred for increased property damage and deterioration resulting from an unreasonable delay in the undertaking or completion of any repair or improvement; or

(2) to the extent that such capital improvements are provided by the landlord in good faith to benefit the tenant. It shall be conclusively presumed that a specific capital improvement, or portion thereof is so provided if, prior to undertaking the improvement, the landlord serves on the tenant of the affected unit and files with the Board, written notice, on a form provided by the Board, which sets forth the maximum increase in rent per affected unit which would result from the improvement, and/or each portion thereof, and, within 30 days of service of such notice, the tenant fails to serve on the landlord, and file with the Board, a written objection to such improvement or portion thereof.

d) Amortized Cost. The annual amortized cost of a capital improvement shall be calculated according to the following formula: the reasonable cost of the capital improvement, plus the cost of financing, divided by the appropriate amortization period for that improvement.

e) Cost of Financing. The cost of financing a capital improvement shall be the actual and reasonable amount of interest and other charges paid to the lender in connection with that portion of any loan necessary to cover the cost of financing.

f) Imputed Financing. If a landlord has financed the capital improvement with her/his own funds, in whole or in part, and the improvement costs at least $1000, or a least $250 per unit

affected, whichever is less, the Cost of Financing for that part shall be deemed to be the amount of financing costs the landlord would have incurred had the landlord financed the capital improvement with a three year loan (or a loan for the period of the useful life of the improvement, whichever is less) at an interest rate equal to the average rate for 26-week U.S. Treasury Bills for the most recent calendar quarter preceding the filing of the petition.

g) Amortization Schedule. The cost of a capital improvement shall be amortized according to a schedule to be established by the Board, unless there is a specific finding that a different time period is more appropriate in a particular instance. For capital improvements not listed in the schedule, the Board shall determine a reasonable amortization period based on all relevant factors.

h) Future Improvements. In order to encourage necessary capital improvements, a landlord may petition for an upward rent adjustment based upon the anticipated future cost of a capital improvement. If the adjustment is granted in whole or in part, it shall not take effect until the capital improvement is completed, and its actual cost and completion is documented to the Board. Adjustments under this sub-section shall not be made for anticipated costs for ordinary repairs and maintenance.

BOARD OF ADJUSTMENTS
CAPITAL IMPROVEMENTS
AMORTIZATION SCHEDULES

Pursuant to Board Regulation Section 531 the following Amortization Schedule is hereby established. The amortization periods in this schedule shall apply to all listed improvements unless the Board makes specific finding based on all relevant factors that a different time period is more appropriate in a particular instance.

IMPROVEMENT	YEARS
Air Conditioner	10
Appliances	
Dishwasher	5
Dryer	7
Fans	10
Garbage Disposal	5
Refrigerator	10
Stove	10
Washing Machine	7
Water Heater	5
Cabinets	10
Carpentry	10
Ceiling	10
Doorbells	10
Doors	10
Dumpster	10
Electrical (light) fixtures	10
Electrical wiring	15
Elevator	15
Fencing	10
Fire Alarm System/Smoke Detector	5
Fire Escape	10

IMPROVEMENT	YEARS
Flooring	
Hardwood	10
Linoleum	5
Tile	8
Carpet	5
Foundation	10
Furniture (bed, table chair, bureau, couch)	5
Gates	10
Gutters, downspouts	10
Heating (gas, electric, central system)	10
Insulation, weather-stripping	10
Landscaping (planting, sprinklers)	10
Locks	5
Mailboxes	10
Masonry	10
Plumbing - fixtures	7
pipes	10
Painting	4
Patio, porch, deck	10
Pump (sump)	10
Paving (asphalt, cement)	10
Plastering	10
Roofing	10
Security system, intercom	10
Siding	10
Solar energy equipment	10
Stairs, steps	10
Wallpaper	5

IMPROVEMENT	YEARS
Walls	10
Windows	5

Section 571 - Notice of Prevailing Rent

(a) Except as provided in subsection (b) within thirty (30) days of the adoption of this regulation by the Board, every landlord of commercial premises in the geographical area covered by the Ordinance shall serve the tenant of each rental unit in such premises with written notice on a form provided by the Board which states all of the following:

i) the base rent for the rental unit;

ii) the method by which the base rent is required to be computed under the Ordinance;

iii) if the rent currently charged the tenant exceeds the base rent for the rental unit, the basis on which the excess is claimed to be an allowable adjustment and the manner in which it is allocated to the tenant's rental unit;

iv) that the tenant has a right to examine all documents on which the landlord relies in claiming that the rent charged is legally permissable; and

v) that the tenant has a right to petition the Board within 120 days of the date the notice was served in order to contest the validity of the rent being charged, and may challenge any rent level within five (5) years of its operative date (this statement shall be in capital letters and shall be underlined).

Section 571 (Continued)

(b) Landlords of rental units subject to existing leases for a fixed term which specify the amount or manner of computing rent and which were executed on or before October 1, 1981, shall serve each tenant of such rental units with a notice which states:

i) that the rent for the rental unit will be governed by the existing lease until it expires;

ii) the date on which the lease is scheduled to expire, unless the lease or the ordinance provides that the lease be renewed;

iii) the method by which the base rent is required to be computed under the applicable section of the ordinance when the lease expires; and

iv) if the lease was executed on or after October 2, 1980, and the difference between the rent charged prior to the execution of the lease (hereafter "prior rent") and the rent in effect under the terms of said lease on June 8, 1982 (hereafter "present rent") exceeds the increase in the Consumer Price Index, for the period beginning the first date that the prior rent became operative to the first date that the present rent became operative, that retroactive to the date the present rent was established or June 8, 1982, whichever is later, the rent be immediately reduced to the prior rent plus such increase in the Consumer Price Index, and that rent overpaid since June 8, 1982 will be refunded.

v) within 30 days of the date any such existing lease expires, the landlord shall serve the tenant of the rental unit the notice described in subsection (a). If under the terms of such lease or the ordinance, a party is given a right to renew the lease, and the right is exercised, the notice required by subsection (a) shall be given within 30 days of the date such renewal lease expires.

(c) A copy of the notices required by subsections (a) and (b) shall be filed with the Board with an attached declaration under penalty of perjury that the tenant has been served.

(d) If the notice required by subsection (a) is not given, within the period set forth in that section, the tenant, shall have the right to serve on the landlord a written notice which states all of the following:

i) that, as of the date of the next rent payment due at least 30 days from date of service of the notice the maximum legal rent for the rental unit shall be the base rent for the rental unit, unless the landlord complies with the notice requirement of subsection (a) before that date;

ii) the amount of the base rent for the rental unit; and

iii) the method by which the base rent is required to be computed under the ordinance and a declaration under penalty of perjury that a good faith and diligent attempt was made to correctly calculate the base rent

for the rental unit, the information used to calculate base rent, and the manner in which it was calculated;

iv) a copy of the notice shall be filed with the Board along with a declaration under penalty of perjury that the notice was served on the landlord.

(e) If within the period specified in the notice by the tenant pursuant to subsection (d), the landlord has failed to serve the tenant with the notice required by subsection (a), the maximum legal rent for the rental unit shall be the base rent specified in the notice served on the landlord pursuant to subsection (d) effective the date of the next rent payment, due at least 30 days from the date of service of that notice and continuing in effect until the next rent payment due at least two weeks from the date the landlord serves on the tenant and files with the Board the notice required by subsection (a).

572 - Notice to New Tenant

(a) Any new tenant who enters into a rental agreement whether written or oral after the adoption of this regulation shall, prior to his or her execution of such a rental agreement be provided with a written notice by the landlord on the form provided by the Board, which states all of the following:

i) the base rent for the rental unit;

ii) the method by which the base rent is required to be computed under the Ordinance;

iii) for each time the rent was increased, whether the previous tenants received the notices required by the ordinance and implementing regulations and a copy of each such notice shall be attached; provided, however, that if the rental unit has been subject to a lease for a fixed term the new tenant shall be served with the notice required by Section 571.

iv) if the rent charged the new tenant exceeds the rent charged the previous tenant, the basis on which the increase is contended to be an allowable adjustment;

v) that the tenant has a right to examine all documents on which the landlord relies in claiming that the rent charged is legally permissable; and

vi) that the tenant has a right to petition the Board within 120 days of the date the notice was served in order to contest the validity of the rent being charged, and may challenge any rent level within 5 years of its operative date (this statement shall be in capital letters and shall be underlined).

572 - Notice to New Tenant (Continued)

(b) A copy of the notice required by subsection (a) shall be filed with the Board along with a declaration under penalty of perjury that a copy was provided to the new tenant.

(c) If a landlord fails to provide to the new tenant and file with the Board the notice required by subsection (a), the new tenant may serve the landlord with a written notice on a form provided by the Board which states all of the following:

i) that, as of the date of the next rent payment due at least 30 days from the date of service of the notice, the maximum legal rent for the rental unit shall be the base rent for that rental unit or the amount specified in the last lawful Notice of Rent Increase served on a tenant at the rental unit and filed with the Board, whichever is greater; provided however that for purposes of this subsection, only, a Notice of Rent Increase will be considered "lawful" if it has not been invalidated by order of the Board;

ii) that the rent will not be reduced in the manner described in subsection (c)(i) if the landlord complies with the notice provisions of subsection (a) before the effective date of the reduction in rent authorized by this Section;

iii) the amount of the reduced rent set in accordance with subsection (c)(i);

iv) if the amount of the reduced rent is the base rent,

the method by which the base rent is required to be computed under the ordinance, and a declaration under penalty of perjury, stating that a good faith and diligent attempt was made to correctly calculate the base rent for the rental unit, the specific good faith efforts made, the information used to calculate the base rent, and the manner in which it was calculated.

(d) A copy of the notice authorized by subsection (c) shall be filed with the Board along with a declaration under penalty of perjury stating the date and manner in which the landlord was served.

(e.) If, within the time period specified in the notice by the tenant, pursuant to subsection (c) the landlord has failed to serve the new tenant with the notice required by subsection (a), the maximum legal rent shall be the rent specified in the notice served on the landlord pursuant to subsection (c) effective the date of the next rent payment due at least 30 days from the date of service of that notice, and continuing in effect until the next rent payment due at least two weeks from the date the landlord serves and files with the Board, the notice required by subsection (a).

573 - Notice of Rent Increase/ Allowable Adjustment

(a) In addition to stating the matters specified in Section 5 (c)(iv) of the Ordinance, a notice of rent increase, shall be on the form provided by the Board and shall state that the tenant has a right to petition the Board in order to contest the validity of the rent increase but must do so within 120 days of the date the notice was served but no later than five years from the effective date of any rent level being challenged. The statement required by this subsection shall be in capital letters and shall be underlined.

(b) A copy of the notice shall be filed with the Board along with a declaration under penalty of perjury describing the manner in which the tenant was served.

(c) In the event that the notice required by Section 5 of this regulation is not served on the tenant, or is incomplete, the rent increase shall be null and void both as to the tenant in occupancy of the unit at the time of such rent increase and as to any subsequent tenant of the premises. The failure of the landlord to file a copy of the notice with the Board shall not render the rent increase null and void, however, the time period for an interested party or neighborhood organization to petition the Board to challenge the rent increase shall be tolled until a copy of such notice is filed with the Board.

574 - Administrative Order of Return to Base Rent/Rent In Last Lawful Notice of Rent Increase

(a) Any tenant who establishes that he or she has exercised the rights provided by Sections 571(d) or 571(c) to reduce rent as a result of the landlord's failure to comply with the Board's notice requirements shall have the right to obtain an administrative order issued in the name of the Board by the Commercial Rent Control coordinator that the rent will be reduced in the manner provided in such sections.

(b) Any order obtained shall not be subject to collateral attack in any unlawful detainer or other proceeding but may be appealed to the Board and any decision rendered by the Board on such appeal shall be subject to review by a court of competent jurisdiction under CCP Section 1094.5.

Section 850 - Right to Petition

Any landlord, tenant, interested party or neighborhood organization may petition the Board for resolution of any dispute, or question concerning the application or interpretation of the ordinance, provided however that the Board shall not re-hear cases involving the application of the ordinance to particular facts.

Section 851 - Time to Petition

(a) A petition to determine the validity of a particular rent level shall be filed within 120 days of:

i) the written notice of a rent increase, required by Section 573 if the petition seeks a determination as to the validity of the increase; or

ii) the written notice of the prevailing rent required by Section 571 if the petition seeks a determination of the validity of the rent at the time the ordinance became effective; or

iii) the written notice to a new tenant required by Section 572 if the petition seeks a determination as to the validity of the rent charged sich a tenant.

(b) The time within which an interested party or neighborhood organization may petition the Board on its own behalf shall be 120 days from when copies of notices required by Sections 571, 572 or 573 were filed with the Board. Such an interested party, neighborhood organization, or the City of Berkeley may petition the Board on behalf of a tenant, if such tenant has failed to petition the Board within the time prescribed. Any such petition shall be filed within 30 days of the expiration of the period for the tenant to petition.

(c) Notwithstanding any other provision of this section, a petition to determine the validity of a particular rent level shall be filed within 5 years of the date such rent level became operative.

Section 852 - Filing of Petitions

(a) Any landlord, tenant, interested party or neighborhood organization seeking a determination from the Board as to the validity of rent charged or proposed to be charged shall complete a petition on forms provided by the Board to which shall be attached all supporting documents to be relied on by the petitioner at the hearing. An original and 12 copies of the petition and attachments shall be filed with the Board along with stamped envelopes addressed to each adverse party along with the filing fee set by the Board. In the case of a landlord petition, the tenant of each affected unit shall be deemed the adverse party. In the case of a tenant petition, the landlord of the affected unit shall be deemed the adverse party. In the case of a petition by an interested party or neighborhood organization, both the landlord and the tenant of the affected unit shall be deemed the adverse party. Upon receipt of a satisfactorily completed petition, the Board shall mail a copy of the petition to each adverse party by certified mail.

(b) Within 30 days of the date of the mailing of such a notice each adverse party shall file a response to the petition to which shall be attached all supporting documents to be relied on at the hearing by the respondent(s). An original and 12 copies of the response(s) shall be filed with the Board of Adjustments along with stamped envelopes addressed to each adverse party.

(c) The case shall be set for hearing within 30 days of the Board's receipt of a completed response and the parties shall be mailed at least fifteen days' written notice of the hearing by the Board by certified mail.

(d) Petitions for units in the same building may be consolidated for hearing.

(e) If no response is received, the case shall be set for hearing within 30 days of expiration of the time to respond prescribed by sub-section (b) and shall be decided on the evidence presented by the petitioner.

Section 853 - Subpoenas

(a) The Board may by subpoena, issued by its staff under its name, require either party or other person to provide any books, records, papers or other evidence deemed relevant to the petition or that any witness appear and testify. Application for a subpoena for records may be made prior to the filing of a petition, but, in any event, must be supported by a declaration under penalty of perjury which states all of the following:

(1) a description of the documents sought;

(2) the contents of the documents sought and the manner in which they are relevant to a pending or prospective petition before the Board; and

(3) if a petition has not yet been filed, that the documents are necessary to the filing of the petition.

(b) Any person subject to a subpoena issued in accordance with subsection (a) may apply for a protective order from the Board if the applicant can establish that:

(1) the information sought is not relevant to any pending or proposed proceeding before the Board; or

(2) the information sought is immune from disclosure pursuant to a provision of law; or

(3) the interests of the applicant in keeping the information confidential outweigh the interests of the public in disclosure of the information, and thus, that a document or portion thereof should only be subject to examination by the parties to a proceeding before the Board and the Board itself and shall not be disclosed to any other member of the public.

(c) Any application for a protective order shall be in writing and shall state the basis pursuant to subsection (b), on which the protective order is sought; shall specify the terms which the applicant asks to be contained in such order and shall be accompanied by a declaration under penalty of perjury that the person who applied for the subpoena under challenge was served with the application for a protective order.

(d) Within ten (10) days of the time such application for a protective order has been served in accordance with subsection (b), the party applying for the subpoena shall file with the Board and serve on the applicant for the protective order a copy of any such response.

(e) Within ten (10) days of the date such response is filed, or if no response is filed, within ten days of the date the response was due, the matter will be set for a hearing before the Board.

(f) In ruling on the request for the protective order the Board shall have the right to examine the information for which the protective order was sought, if necessary, provided, however, that with respect to an application for a protective order under subsection (b) (3), the person who applied for the subpoena shall also be permited to examine the information relating to which the protective order is sought. The decision of the Board shall be in writing and shall be mailed to the parties within ten days of the hearing.

(g) The time limits to file a petition or to respond shall be tolled during the period that an application for a protective order is pending.

Section 854 - Hearing By Board

All hearings shall be conducted by the Board of Adjustments sitting en banc, which shall have the following powers:

(a) to administer oaths and affirmations;

(b) to grant requests for subpoenas, to order the production of evidence, and to issue protective orders;

(c) to rule upon offers of proof and receive evidence;

(d) to regulate the course of the hearing and rule upon requests for continuances;

(e) to call, examine, and cross-examine witnesses, and to introduce evidence into the record;

(f) to make and file decisions on petitions in accordance with this Chapter;

(g) to take any other action that is authorized by these regulations or the Ordinance.

Section 855 - Disqualification of Interested Board Member

(a) No member of the Board of Adjustments shall take part in any hearing on a petition in which she/he has a personal financial interest in the outcome (such as being the landlord of or a tenant residing in, the property that is involved in the petition), or a personal bias for/ against any party.

(b) Board members shall disclose to all parties any prior communications with a party concerning the subject of the petition as well as any possible or apparent personal Financial interest or personal bias.

(c) Any Board member may disqualify himself or herself at any time. In addition, any party may file a written request for disqualification, stating the grounds with the Board Chairperson at least 72 hours prior to the hearing. Any such request shall be ruled upon prior to the taking of any evidence at the hearing.

Section 856 - Evidence

The Board need not conduct the hearing according to the technical rules of evidence. Any relevant evidence may be considered if it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs, regardless of any common law or statutory rule which might exclude such evidence in court proceedings provided however that the decision of the Board as to a material issue of fact may not be based solely on inadmissible hearsay if such hearsay was objected to at the hearing.

Section 857 - Conduct of Hearing

(a) The party with the burden of proof on the majority of the issues to be determined shall be required to present his or her case first irrespective of whether such party was the petitioner.

(b) Each party shall have the right to present testimony and to confront and cross-examine adverse witnesses.

(c) No new documentary evidence shall be presented at the time of the hearing except upon a showing of good cause, and upon the granting of a continuance to the adverse party for a reasonable time if requested by such party.

Section 858 - Decision by the Board

(a) The decision of the Board shall be by a majority of the Board, shall be in writing and shall be rendered within 45 days of the date of the hearing and shall be mailed to the parties.

(b) If the Board finds a rent level to be in excess of the limits imposed by the Ordinance, it shall adjust the rent downwards effective 30 days from the date of the mailing of the notice. Such adjustment shall provide for and schedule reimbursement to the tenant for any overpayments in rent.

(c) The decision of the Board shall be final and binding on the thirtieth day after the date it is mailed but may be reviewed by a court of competent jurisdiction pursuant to Code of Civil Procedure Section 1094.5.

(d) The prevailing party shall be awarded as costs reasonable legal accounting or filing fees incurred in connection with the proceeding before the Board provided, however, that the Board may in its decision stipulate the manner in which such costs awarded may be recovered. For purposes of determining an award of attorney's fees, the determination of who is a prevailing party shall be made in accordance with Section 11E of the Ordinance.

Section 859 - Hearing Record

The hearing before the Board shall be tape recorded. The tape recording shall be transcribed upon the request of any party who posts in advance the estimated cost of the transcription. Either party, may provide, at his or her own expense, a reporter to transcribe the hearing. The official record of the hearing shall include the petition, the response thereto, all documents introduced into evidence, offers of proof, the decision of the Board and a transcript of the hearing.

Section 1351 - Existing Leases

a) Except as provided in sub-section b) below, a rental unit with a lease for a fixed term, executed on or before October 1, 1981 shall have its rent governed by the terms of the lease until it expires. If, under the terms of such lease or of the ordinance, a party is given a right to renew the lease, and the right is exercised, the rental unit shall have its rent governed by the terms of such renewal lease until it expires.

b) Leases executed between October 2, 1980 and October 1, 1981 shall be subject to the following limitations:

(i) the difference between the rent charged prior to the execution of the lease (hereafter "prior rent") and rent in effect under the terms of such lease on June 8, 1982 (hereafter ("present rent") shall not exceed the increase in the Consumer Price Index for the period beginning the first date that the prior rent became operative, to the first date that the present rent became operative.

(ii) any excess rent paid over the ceilings established by sub-section b)(i) since June 8, 1982 shall be re-funded to the tenant; and

(iii) any future increases in rent will be subject to the lease as provided in sub-section a) provided however than any increase in rent authorized by the lease over a specific period shall not exceed the increase in the Consumer Price Index for the

corresponding period and the tenant shall be given 30 days prior written notice of each increase authorized by the lease on a form provided by the Board.

c) In calculating increases in the Consumer Price Index the index with the closest publication date shall be used.

NOTICE OF PREVAILING RENT
(Required by Board Regulation 571)

TO: (Name of Tenant)_____

(Address of Rental Unit)_____

_____

THIS NOTICE CONCERNS THE PREVAILING RENT OF YOUR UNIT:

1. PREVAILING RENT - Landlords, check and complete one of the following:

[ ] A. Your unit has no existing lease or it is subject to an existing lease which was executed on or after October 2, 1981. This means that your prevailing rent is equal to the base rent plus any allowable adjustments for expenses that have increased since the end of the period used for calculating base rent.

Base Rent $_____per_____(Time period)
(See Section II of this form for details)

Allowable Adjustments $_____per_____(Time period)
(See Section III of this form for details

PREVAILING RENT (TOTAL) $_____per_____(Time period)

[ ] B. Your unit is subject to a lease for a fixed term which was executed on or before October 1, 1980 and thus is not subject to the rent limits of the Ordinance until the lease expires. This means that the prevailing rent is equivalent to the rent specified in the lease.

The lease expires on:_____.
(Note to Landlord: Do not fill in the date if the lease contains a renewal option or the ordinance gives either party a right to renew the lease.)

At the time of the lease expiration, the base rent is required to be computed under section _____ of the Ordinance.

PREVAILING RENT (TOTAL) $_____per_____(Time period)

[ ] C. Your unit is subject to a lease for a fixed term executed between October 2, 1980 and October 1, 1981. The prevailing rent is the lease rent adjusted by the CPI ceiling as calculated in Section IV of this form until the lease expires.

PREVAILING RENT (TOTAL) $_____per_____(Time period)

[ ] D. Other. Explain:_____

_____

_____

_____

PREVAILING RENT (TOTAL) $_____per_____(Time period)

On the Back of This Notice Are Sections Explaining The Calculations of Base Rent, Allowable Ajudstments and CPI Ceiling on Lease Rents. Relevant Support Documents are Attached.

IF YOU WISH TO DSIPUTE THE LEGALITY OF THE RENT BEING CHARGED, YOU MUST FILE A PETITION WITH THE BOARD OF ADJUSTMENTS, COMMERCIAL RENT STABILIZATION OFFICE, 2180 MILVIA STREET, BERKELEY, CALIFORNIA WITHIN 120 DAYS OF THE DATE THIS NOTICE WAS SERVED ON YOU, BUT NO LATER THAN FIVE (5) YEARS FROM THE EFFECTIVE DATE OF A PARTICULAR RENT LEVEL CHALLENGED.

Signature_____ (Address, print)_____

(Name, print)_____ _____

II. BASE RENT

The amount of the base rent is $_____ per _____ (time period). It is required by the Ordinance to be computed by the following method:

[ ] A. Rent in effect on October 1, 1981 (Section 5(b)).

[ ] B. Last rent under lease in effect on October 1, 1981 which called for fixed payments of varying amounts (Section 5(b)(i)).

[ ] C. Gross sales method. (Section 5(b)(ii)).

[ ] D. Rent had not been raised for _____ years prior to June 8, 19812 and therefore the base rent was increased by 5% for each year of no increase for a total of _____% to $_____. (Section 5(b)(iii)).

[ ] E. Other. Explain: _____

_____

(Note to Landlord: Check applicable box above and set out on a separate sheet the step-by-step calculation you made in determining the amounts under relevant sections of the ordinance. The sheet must be attached to this notice.)

III. ALLOWABLE ADJUSTMENTS

The end of the period used for calculating base rent is _____ 1/ and is referred to below as the "base rent date." The amount of Allowable Adjustments to the Base Rent is:
$_____ per _____ (time period). It is the total of the increase in the following expenses incurred since the base rent date.

	Monthly Cost in 12 month period ending with base rent date.	Monthly Cost since base rent date.	Amount of Increase
1. Maintenance & Operating Expenses			
2. Property taxes and/or fees in connection with property.			
3. Costs as a result of capital improvements (Amortization schedule must be attached)			
4. Allowable financing costs			
5. Other (Specify)_____			
6.		TOTAL	

7. The way in which these costs are allocated to your building is as follows: (Set out calculations for multi-unit buildings.)

_____

_____

1/ Note to Landlord - This date will depend upon the method you are required to use to calculate base rent, e.g., if your base rent is calculated by the method set forth in II(B) above, the base rent date will be the date the lease expired.

IV. Consumer Price Index (CPI) Ceiling on Rents Set by Leases for Fixed Terms Executed Between October 2, 1980 and October 1, 1981.

A. Date lease was executed _____(date).

B. Rent that would be in effect today under the lease $_____.

C. Date rent in B went into effect_____.

D. Prior to date specified in A, last rent in effect for this unit. $_____.

E. Date when rent specified in D went into effect_____.

F. Difference between rent specified in B and rent specified in D (B - D). $_____.

G. % increase in lease rent

$$\frac{F \times 100}{D} = \_\_\_\_\_\%$$

H. Consumer Price Index for date in C :[2/] _____(CPI Number)

I. Consumer Price Index for date in E:_____(CPI Number)

J. Change in CPI (H - I)

K. % increase in CPI

$$\frac{J \times 100}{I} = \_\_\_\_\_\%$$

L. Indicate G or K, whichever is smaller:_____.

M. Prevailing rent is lease rent adjusted by CPI ceiling

$$D + (D \times L) = \$\_\_\_\_\_.$$

NOTE

From now on the rent in your unit will be that set by your current lease until it expires, but no increase authorized may exceed the increase in CPI during a corresponding period.
The lease will expire on:_____[3/]
At that time the lease rent is required to be computed under Section_____ of the Ordinance. You are entitled to 30 days written notice of each such increase.

2/ Note to Landlord: Use All Items Consumer Price Index for All Consumer; S.F.-Oakland, CA; indicate index number for closest publication date. This index is published every month for the S.F.-Oakland Metropolitan Area and is available at the Reference Desk of the Berkeley Main Library (644-6648) and the Claremont Branch Library (644-6880).

3/ Note to Landlord: Do not fill in this date if your lease or the Ordinance gives either party the right to renew the lease.

NOTICE TO NEW TENANT
(Required by Board
Regulation 572)

TO: (Name of Tenant)_____

(Address of rental unit)_____

_____

I. LAST PREVIOUS NOTICE SERVED: (date)_____. The last Notice of Prevailing Rent which was served on the previous tenant indicated that:

[ ] A. The amount and basis for the base rent and all allowable adjustments. The notice is attached.

The base rent is $_____ per _____ (time period).

was established on _____(date).

[ ] B. The base rent had not yet been established because:

[ ] 1. The rent of the unit was previously subject to a lease executed on or before October 1, 1980.

OR

[ ] 2. The rent of this unit was previously subject to a lease executed between October 2, 1980 and October 1, 1981, adjusted by a CPI ceiling.

(Note to Landlord: You must serve a notice of prevailing rent on the new tenant if you checked either B(1) or B(2) and the lease has now expired.)

II. RENT INCREASES SINCE THE LAST NOTICE. Since the last notice of prevailing rent was served, the rent was increased as follows:

Rent accordint to last notice of prevailing rent : $_____ per _____ (time period)

Rent increases:

A. Allowable Adjustments totalling: $_____per_____(time period)
(attach each notice of rent increase)

B. Determined by lease executed on or prior to 10/1/80 totalling : $_____per_____(time period)
(Attach copy of lease)

C. Determined by lease executed between 10/2/80 and adjusted by the CPI ceiling totalling : $_____ per _____(time period)
(attach notices of rent increases and copy of lease)

D. Last rent in effect for unit prior to new tenant : $_____per _____(time period)

III. RENT INCREASES SINCE PRIOR TENANT. The rent I am charging you, the new tenant, is higher than the last rent in effect for the prior tenant because of the following:

A. Allowable Adjustments, i.e. increases in my costs since the date that I last raised the rent of the prior tenant, which was on:

_____, the date the notice of rent increase was served or the date the new rent went into effect under the terms of an existing lease executed on or before October 1, 1981.

(See page 2 for calculations.)

	Monthly Cost in 12 Month Period Prior to Law Rent Increase To Prior Tenant	Monthly Cost Since Last Rent Increase to Priot Tenant	Amount of Increase
1. Maintenance & Operating Expenses			
2. Property Taxes and/or Fees In Connection with the Property.			
3. Costs as a result of capital improvements (Amortization schedule must be attached)			
4. Allowable Financing Costs			
5. Other (Specify):			
6.		TOTAL	

7. Costs Allocated to Tenants Unit is as follows:
(Specify method of apportionment for multi-unit building):_____

_____

_____

[ ] B. Increases Called For In An Unexpired Lease That Was Executed:

[ ] 1. On or prior to 10/1/81
The amount of the increase is: $_____

[ ] 2. between 10/2/80 and 10/1/81 and adjusted by CPI ceiling. Calculations of the CPI ceiling are attached.
The amount of the increase is. $_____

IV. RENT LEVEL FOR NEW TENANT

A. Last rent in effect for unit prior to new tenant (Section IID of this form) $_____ per _____ (time period)

B. Cost increases since prior tenant (See Section III of this form) $_____ per _____ (time period)

C. Rent for the New Tenant: TOTAL $_____ per _____ (time period)

You have a right to examine any documents upon which I have based statements made in this notice.

IF YOU WISH TO DISPUTE THE LEGALITY OF THE RENT BEING CHARGED, YOU MUST FILE A PETITION WITH THE BOARD OF ADJUSTMENTS, COMMERCIAL RENT STABILIZATION OFFICE, 2180 MILVIA STREET, BERKELEY, WITHIN 120 DAYS OF THE DATE THIS NOTICE WAS SERVED ON YOU, BUT NO LATER THAN FIVE (5) YEARS FROM THE EFFECTIVE DATE OF A PARTICULAR RENT LEVEL CHALLENGED.

(Signature)_____ (Address, print)_____

(Name, print)_____ _____

(If you have any questions about the new law, call 644-6175)

NOTICE OF RENT INCREASE/
ALLOWABLE ADJUSTMENT
SECTION 573

TO: (Name of Tenant)_____

(Address of Unit)_____

_____

PLEASE TAKE NOTICE that effective _____(date) 1/ your rent will be raised from its present level of:

$_____per_____(time period) to $_____per_____(time period)

The amount of the increase constitutes allowable adjustments under the applicable rent law because of the following increases in my costs since the date your present rent was

established on:_____(date base rent established; or notice of rent increase/allowable adjustment was served on tenant, or date rent went into effect under the lease.)

1/ Note to Landlord: State law prescribes the period for giving written notice of a rent increase. You must fill in the date based upon state law requirements that apply to your situation.

METHOD OF CALCULATING RENT INCREASE/ALLOWABLE ADJUSTMENT

	Monthly Cost in 12 Month Period Ending with Date Present Rent Was Established	Rent Costs Since Present Rent Was Established	Amount of Increase
1. Maintenance & Operating Expenses	_____	_____	_____
2. Property Taxes and/or Fees in Connection with the Property	_____	_____	_____
3. Costs as a result of capital improvements (Amortization schedule must be attached)	_____	_____	_____
4. Allowable Financing Costs	_____	_____	_____
5. Other (specify): _____	_____	_____	_____
6.		TOTAL	_____
7.			_____
8.	Present Rent + Allowable Adjustments = NEW RENT		_____

Costs were allocated to Tenant's Unit as follows:
(Specify method of apportionment in your multi-unit building)

_____

_____

You have a right to examine any document on which I base these statements within 10 days of your request. If I deny your request, the rent increase will be null and void.

IF YOU WISH TO DISPUTE THE LEGALITY OF THE RENT BEING CHARGED, YOU MUST FILE A PETITION WITH THE BOARD OF ADJUSTMENTS, COMMERCIAL RENT STABILIZATION OFFICE, 2180 MIVLIA STREET, BERKELEY, CALIFORNIA, WITHIN 120 DAYS OF THE DATE THIS NOTICE WAS SERVED ON YOU.

(Signature)_____ (Address)_____

(Name, print)_____ _____

NOTICE OF RETURN TO BASE RENT,
THE RENT IN LAST LAWFUL NOTICE
OF RENT INCREASE
(Authorized by Regulations 571
& 572)

TO: (Name of Landlord)_____

(Address of Landlord)_____

_____

PLEASE TAKE NOTICE that since I have not been served with a:

[ ] A. Notice of Prevailing Rent as provided for by the Elmwood Rent Stabilization and Eviction Protection Ordinance and Regulation 571.

[ ] B. Notice to New Tenant as provided for by the Elmwood Rent Stabilization and Eviction Protection Ordinance and Regulation 572.

It is my right (under Section 571(c) and (d) or Section 572(c) and (d) to set the rent for my unit at $_____per_____(time period); which is:
(Note to Tenant: Check and complete applicable section below.)

[ ] 1. the rent stated in the last lawful notice of rent increase or notice of prevailing rent on file with the Board in the amount of:

$_____per_____(time period); or, if no such notice is on file.

[ ] 2. the base rent for the unit. The base rent is required by the Ordinance to be computed by the following method. (Note to Tenant: Check applicable box and set out on a separate sheet of paper, the step by step calculations you made in determining the amounts under the relevant sections of the ordinance. The sheet must be attached to this notice. Include relevant documentation.):

[ ] a. Rent in effect on October 1, 1981 (Section 5(b)).

[ ] b. Last rent under lease in effect on October 1, 1981 which called for varying rent levels. (Section 5(b)(i)).

[ ] c. Gross Sales method. (Section 5(b)(iii)).

[ ] d. Rent had not been raised for _____years prior to June 8, 1982 and therefore the base rent was increased by 5% for each year of no increase for a total increase of:

_____% to $_____. (Section 5(b)(iii))

[ ] e. Other: (Cite applicable section of the Ordinance)_____

_____

_____

DUE DILIGENCE I, _____(name), hereby declare that in order to accurately determine the base rent level for my unit, I have made the efforts described on the attached sheet to secure needed information diligently and in good faith.

I DECLARE UNDER PENALTY OF PERJURY THAT THE FOREGOING IS TRUE AND CORRECT, AND THAT THIS DECLARATION WAS EXECUTED AT:

_____, CALIFORNIA ON _____(date).

The reduced rent will go into effect on:_____; (which is the date the next rent is due, and is at least 30 days from the date this notice is served) unless, prior to this date, you establish a rent level for this unit that takes into account your increased costs by serving me with proper notice on the forms provided by the City of Berkeley.

(Signature)_____ (Address)_____

(Name, print)_____ _____

BOARD OF ADJUSTMENTS

CITY OF BERKELEY

_____, Petitioner, vs. _____, Respondent.	REQUEST FOR ADMINISTRATIVE ORDER TO RETURN TO BASE RENT/ LAST LAWFUL NOTICE OF RENT INCREASE

Because my landlord has not served me with:

[ ] A. Notice of Prevailing Rent as provided for by the Elmwood Rent Stabilization and Eviction Protection Ordinance and Regulation 571.

[ ] B. Notice to New Tenant as provided for by the Elmwood Rent Stabilization and Eviction Protection Ordinance and Regulation 572.

It is my right (under Section 571(c) and (d) or Section 572(d) and (d)) to request an administrative order setting the rent for my unit at:

$_____ per _____(time period) which is:
(Note to Tenant: Check and complete applicable section below)

[ ] 1. The rent stated in the last lawful notice of rent increase or notice of prevailing rent on file with the Board in the amount of:

$_____ per _____(time period), or if no such notice is on file,

[ ] 2. The base rent for the unit.

A copy of the Notice of Return to Base Rent/Rent In Last Lawful Notice of Rent Increase is on file with the Board of Adjustments, Commercial Rent Stabilization Office, along with a declaration under penalty of perjury, that my landlord was served with the notice on:

_____(date).

I understand that the landlord may establish a rent level for this unit that takes into account increased costs by serving me with proper notice on the forms provided by the City of Berkeley and filing a copy with the Board of Adjustments.

Accordingly, I am requesting an order stating that the rent for the unit I am renting will be:

$ _____ beginning _____.
(the next rent due date, and at least 30 days from the date this notice was served)

which will remain in effect until the landlord gives me required notice.

Date:_____ (Signature)_____

(Name, print)_____

(Address of Rental Unit)_____

_____

BOARD OF ADJUSTMENTS

CITY OF BERKELEY

_____, Petitioner, vs. _____, Respondent.	ORDER OF RETURN TO BASE RENT/ RENT IN LAST LAWFUL NOTICE OF RENT INCREASE

TO: Name of Landlord_____ Re: (Address of Rental Unit)

Address_____ _____

_____ _____

Please take notice that City records indicate that the tenant at the above address has not been served with a:

[ ] A. Notice of Prevailing Rent as provided for by the Elmwood Stabilization and Eviction Protection Ordinance and Regulation 571.

[ ] B. Notice to New Tenant as provided for by the Elmwood Rent Stabilization and Eviction Protection Ordinance and Regulation 572.

Section _____ provides that the Commercial Rent Stabilization Office may order the rent for the unit to return to :

$_____ per _____(time period), which is:

[ ] 1. The rent stated in the last lawful notice of rent increase or notice of prevailing rent on file with the Board in the amount of:

$_____ per _____(time period), or if no such notice is on file.

[ ] 2. The base rent for the unit.

This rent of $_____ per _____(time period) will go into effect on

_____(date) which is at least 30 days from the date the tenant served you with a Notice of Return to Base Rent/Rent in Law Lawful Notice of Rent Increase. It will continue in effect until the next rent payment due at least two weeks after you have served the tenant with proper notice and filed a copy with this office.

Date:_____

COMMERCIAL RENT STABILIZATION COORDINATOR
2180 Milvia Street
Berkeley, California 94704

644-6175

ELMWOOD COMMERCIAL RENT
STABILIZATION AND EVICTION
PROTECTION PROGRAM
2180 Milvia Street
Berkeley, California 94704
644-6

(LOGO)

FOR STAFF USE ONLY
Date Filed:

APPEAL/REVIEW OF
PREVAILING RENT
(Form No. _____)

I. This petition is to appeal/review a rent level at the following property:

_____

_____

II. Petitioner is

A. [ ] Tenant _____
(name)

_____
(mailing address if different from above)

B. [ ] Owner/Manager _____
(name)

_____
(mailing address if differnt from above)

C. [ ] Interested Party _____
(name)

_____
(mailing address)

I have an interest in the rents which prevail at this commercial unit because:

_____

_____

_____

D. [ ] Interested Neighborhood Organization _____
(name)

_____
(mailing address)

I have an interest in the rents which prevail at this commercial unit because:

_____

_____

III. This appeal/review concerns a rental unit:

A. [ ] for which there is no existing lease.

B. [ ] which is subject to an existing lease which was executed on or after October 2, 1981 and thus the unit is subject to provisions of the ordinance regarding base rent and allowable adjustments.

C. [ ] which is subject to a lease which was executed on or before October 1, 1980 and thus is not subject to the rent limits of the ordinance until the lease expires.

D. [ ] which is subject to a lease executed between October 2, 1980 and October 1, 1981 and thus, the rents which can be charged under the lease, cannot exceed certain ceilings which are tied to the Consumer Price Index.

E. [ ] Other (explain) _____

_____

_____.

IV. This petition is being filed to appeal/review:

A. [ ] a notice of prevailing rent, which was served on the tenant by:

1. [ ] personal delivery on _____ (date)

2. [ ] certified mail on _____ (date)

and filed with the Board on _____ (date)

B. [ ] a notice of rent increase which was served on the tenant by:

1. [ ] personal delivery on _____ (date)

2. [ ] certified mail on _____ (date)

and filed with the Board on _____ (date)

C. [ ] a notice to a new tenant which was served on the tenant by:

1. [ ] personal delivery on _____ (date)

2. [ ] certified mail on _____ (date)

3. [ ] the new tenant executed the lease on _____.

COPIES OF THESE NOTICES MUST BE ATTACHED TO PETITION

D. [ ] Other (explain) _____
_____
_____.

V. The questions to be resolved on this appeal/review are:

A. [ ] whether the base rent for a unit was properly computed.
(Fill out Section VI if you check this box)

B. [ ] whether the difference between the base rent and the prevailing rent constitutes an allowable adjustment.
(Fill out Section VII if you checked this box)

C. [ ] whether a rent increase is based on allowable adjustments.
(Fill out Section VII if you checked this box)

D. [ ] whether rent levels authorized by a lease executed between October 2, 1980 and October 1, 1981 were properly limited to corresponding increases in the Consumer Price Index.
(Fill in Section VIII if you checked this box)

VI. Base Rent (Fill this section out only if your appeal/review relates to the way in which base rent was computed, i.e. you checked IV(A) above)

The amount of the base rent according to the notice served on the tenant is $_____ per _____ . It is required
(time period - e.g. month)
by the Ordinance to be computed by the following method:

A. [ ] Rent in effect on October 1, 1981. (Section 5(b))

B. [ ] Last rent under lease in effect on October 1, 1981 which called for fixed rent payments of varying amounts (e.g. rents escalating with Consumer Price Index) (Section 5(b)(i)).

C. [ ] Gross sales method. (Section 5(b)(ii))

D. [ ] Rent had not been raised for _____ years prior to June 8, 1982 and therefore the base rent was increased by 5% for each year of no increase for a total increase of _____% to $_____.
(Section 5(b)(iii).

E. [ ] Other (explain) _____
_____
_____.

This appeal/review covers the manner in which base rent is set and the issues are described below:

_____
_____
_____
_____.

d. [ ] increases in allowable financing costs (explain issue) _____

e. [ ] the manner in which the cost was allocated to the unit (explain issue) _____

f. [ ] Other _____

VIII Consumer Price Index (CPI) Ceiling on Rents Set by Leases for Fixed Terms Executed Between October 2, 1980 and October 1, 1981.

A. Date lease was executed _____(date).

B. Rent that would be in effect today under the lease $_____.

C. Date rent in B went into effect_____.

D. Prior to date specified in A, last rent in effect for this unit. $_____.

E. Date when rent specified in D went into effect_____.

F. Difference between rent specified in B and rent specified in D (B - D). $_____.

G. % increase in lease rent

$$\frac{F \times 100}{D} = \_\_\_\_\_\%$$

H. Consumer Price Index for date in C: [2/] _____(CPI Number)

I. Consumer Price Index for date in E: _____(CPI Number)

J. Change in CPI (H - I)

K. % increase in CPI

$$\frac{J \times 100}{I} = \_\_\_\_\_\%$$

L. Indicate G or K, whichever is smaller:_____.

M. Prevailing rent is lease rent adjusted by CPI ceiling

$$D + (D \times L) = \$\_\_\_\_\_.$$

VII. Allowable Adjustments (Fill in this section only if your appeal/review relates to whether a rent increase or rent excess over base rent is an allowable adjustment)

The question to be resolved on this appeal/review relates to: whether the amount by which the present rent exceeds either the base rent or the last allowable adjustment is the result of increases in costs since the time the base rent or last allowable adjustment was established.

A. [ ] the present rent at the unit is $_____ per _____.

B. [ ] the base rent is $_____ per _____ and was established for the period ending _____ _____.

C. [ ] the rent has been increased to $_____ per _____ effective _____ date from $_____ per _____ the old rent, which was established on _____ date _____.

D. [ ] The Board is asked to resolve questions relating to the following issues:

a. [ ] increases in maintenance and operating expenses: (explain issue)_____
_____
_____
_____
_____

b. [ ] increases in property taxes and/or fees in connection with the property (explain issue) _____
_____
_____
_____
_____

c. [ ] increased costs for capital improvements (explain issue) _____
_____
_____
_____
_____

The issue on this appeal/review relates to: (explain) _____

_____

_____

_____

_____

_____

_____

ATTACHED TO THIS PETITION ARE ALL SUPPORTING DOCUMENTS AND NOTICES RELEVANT TO THIS PETITION. I UNDERSTAND THAT I WILL NOT BE ABLE TO INTRODUCE DOCUMENTS AT THE HEARING AND THAT I COULD HAVE SUBPOENAED ANY DOCUMENTS TO WHICH I DID NOT OTHERWISE HAVE ACCESS.

Dated: _____

Signature

FAIR RATE-OF-RETURN
PROPOSED REGULATIONS
AND REPORTS.

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322-251 25M SETS 10/82

CITY OF BERKELEY

Memorandum

DATE: July 25, 1983

TO: BOARD OF ADJUSTMENTS

FROM: MEASURE I SUBCOMMITTEE

SUBJECT: FINAL RECOMMENDATIONS FOR "FAIR RETURN ON INVESTMENT" STANDARDS

On Feburary 24, 1983, Consultants Baar and Keating presented to the Board a report entitled "Final Recommendations: Fair Return Standards under Elmwood Commercial Rent Controls," which was then officially circulated for public review and comment. The proposed modifications to the final recommendations are the result of four months of deliberation by the Subcommittee, taking into consideration both the views of the affected public and existing conditions in the Elmwood District.

While there are areas of disagreement between the subcommittee members, specifically regarding annual inflationary adjustments and the extent to which inflationary rent increases should be discretionary rather than automatic, these are considered to be issues which should be brought to the full Board for resolution. These modifications therefore, represent a general consensus of the Subcommittee as to the most appropriate method of addressing the issue of fair return on investment for commercial properties in the Elmwood District.

The rationale for the approach chosen is set forth in the consultants' reports dated November 10 and December 6, 1982, previously presented to the Board. Further, discussion of the approach (with modifications) was presented in the February 24 report, referred to above.

322-251 25M SETS 10/82

CITY OF BERKELEY

DATE: July 27, 1983 **Memorandum**

TO: Berkeley Board of Adjustments

FROM: Dennis Keating, Consultant

SUBJECT: PROPOSED FAIR RATE-OF-RETURN REGULATIONS

The attached revised Fair Return Regulations represent the final recommendations of Ken Baar and myself after extensive consultations with the Board's Measure I Subcommittee and Elmwood landlords and tenants since the submission of our report on February 24, 1983. Representatives of Elmwood landlords and tenants were given the opportunity of responding to this report, which they did essentially; our recommendations remain the same as those previously submitted. We recommend that the fair return formula be the maintenance of landlord's net operating income (NOI) as of a base year (1981) with an annual adjustment for inflation. Those landlords with unusually low rents would be eligible for an adjustment of the base rent.

The fair return process recommended previously would be the same. All Elmwood landlords would be required to register their 1981 income and expenses and square footage, which would be subject to tenant challenge and Board review. Once at least 50% of the regulated units are registered, the Board will calculate the 1981 base NOI per square foot. This will be the basis for future fair return adjustments. Landlords will be permitted to "bank" allowable rent increases.

However, several significant changes in this formula are recommended. These changes are incorporated in the attached revised draft regulations.

1. Annual Rent Increases

We continue to recommend that the NOI of Elmwood's landlords be adjusted annually to guarantee a fair return. However, we recommend the following two changes:

a) NOI Standard

We originally recommended that an annual rent adjustment of NOI be based on the mean NOI/square foot in 1981 (base-year). In view of the small number of units involved, the use of the mean may "skew" and distort the NOI fair return standard. Therefore, we recommend that the median, rather than the mean, base-year NOI be used. This will better reflect the proper NOI as the basis for the fair return formula.

b) Inflation Adjustment

We originally recommended that the base NOI be fully indexed to inflation. It was argued that fully indexing NOI for inflation is not legally required and that this is unduly generous to landlords, at least those whose leases do not include CPI inflation adjustments.

Tenants, for example, argued that NOI be indexed at 40% of the inflation rate similar to the current formula used by the Santa Monica Rent Control Board.

We recommend that, instead of fully indexing the 1981 median NOI/square foot to inflation, the 1981 median NOI/square foot be adjusted fully for inflation up to 7% of the San Francisco-Oakland Consumer Price Index (CPI). If the annual CPI increase exceeds 7%, then 50% of the CPI increase between 7% up to 14% should be applied to adjust the 1981 median NOI/square foot. Inflation exceeding 14% would not be applied to NOI. Therefore the maximum allowable annual adjustment to index the base median NOI for inflation would be 10.5% (assuming that inflation exceeded 14%) of the prevailing rent.

All landlords in compliance with these regulations would be eligible for this annual rent adjustment.

2. Base Rent Adjustment

As discussed above, we originally recommended that the mean 1981 NOI be used as the fair return standard. However, we are recommending that instead the median 1981 NOI be used. Originally, we recommended that landlords whose 1981 rents per square foot were below the mean Elmwood rent be allowed to increase them incrementally to that level (annual base rent adjustments not to exceed 20% annually.

We now recommend that landlords whose 1981 rents were below the Elmwood 1981 median rent be allowed to increase them to that level, not to exceed 25% of the prevailing rent.

3. Overall Annual Rent Increase Ceiling

We originally recommended a 20% ceiling for annual base rent adjustments. In accordance with the Committee's wishes, there was no overall annual ceiling.

In response to comments, we recommend an overall annual rent increase ceiling of 25% of the prevailing rent. This includes:

- any increased operating and maintenance costs paid by the landlord which may be passed on to the tenant (including amortized capital improvements);
- the annual inflation adjustment (not to exceed 10.5%); and
- any base rent adjustment (to which a landlord is entitled).

CITY OF BERKELEY

Memorandum

DATE: July 27, 1983

TO: Berkeley Board of Adjustments

FROM: Dennis Keating, Consultant

SUBJECT:

4. Banking

We recommend that those landlords immediately subject to Measure I be allowed to bank any of the above rent increases to which they may be entitled until vacancy of the unit by the existing tenant. The banked rent increases may then be applied to the new tenant, as long as the landlord provides the Board and the new tenant with a detailed explanation of how the banked rent increase was calculated and provides an affidavit from the previous tenant that the prior tenant did not pay such an increase already. The 25% annual rent increase ceiling would not apply to such banked rent increases.

Attachment

BOARD OF ADJUSTMENTS RESOLUTION
ADOPTING FAIR RETURN ON INVESTMENT REGULATIONS FOR
ORDINANCE NO. 5468-N.S., THE ELMWOOD COMMERCIAL RENT
STABILIZATION AND EVICTION PROTECTION ORDINANCE

WHEREAS, Section 6 of City of Berkeley Ordinance No. 5468-N.S., the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance, required the enactment of fair return on investment regulations, in implementation of the Ordinance; and

WHEREAS, the Board of Adjustments is charged with implementing the provisions of the Ordinance; and

WHEREAS, the Board of Adjustments may adopt rules and regulations to discharge its responsibilities under the Ordinance.

NOW, THEREFORE, Be It Resolved by the Board of Adjustments of the City of Berkeley as follows:

1. The attached regulation sections are hereby adopted as regulations of the Board;

2. The staff is hereby authorized to modify any forms required by the Board, if in its judgment such revisions are appropriate.

400 - Definitions - Same as those in Ordinance

Unless otherwise specified, in a specific regulations, or further defined in this chapter the terms used in regulations implementing the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance shall have the meaning set forth in Section 4 of that Ordinance.

401 - "Board"

The word "Board used in these regulations shall mean the Board of Adjustments of the City of Berkeley and the Commercial Rent Stabilization office of the Board.

402 - "Ordinance"

The word "Ordinance" used in these regulations shall mean the Elmwood Commercial Rent Stabilization and Eviction Protection Ordinance.

403 - "Square Footage"

The term "square footage" used in these regulations shall mean the total gross renter interior commercial floor area, unless determined to be otherwise by the Board due to special circumstances in accordance with the intent of the parties and the purpose of the Ordinance. Common space in buildings occupied by more than one tenant shall be apportioned equally among actual tenant users.

404 - "Net Operating Income"

The term "net operating income" used in these regulations shall mean the gross rent minus maintenance and operating expenses (as defined in Section 530) and amortized capital improvements (as defined in Section 531), exclusive of debt service.

FAIR RETURN REGULATIONS UNDER ELMWOOD COMMERCIAL RENT CONTROLS

Section 600 - Purpose

The purpose of these regulations is to provide landlords with a fair return, by permitting annual increases in net operating income over the 1981 base period and by permitting landlords who charge below average rents for the Elmwood district to raise their rents to the median for the regulated commercial district.

Section 605- Registration Statement

(a) All landlords shall be required to complete and return registration statements on a form provided by the Board (attached as Appendix A of this regulation). Said forms shall provide information as to: ownership, tenant, rent, square footage, operating and maintenance expenses, and any other information required by the Board as to the year 1981.

(b) All landlords shall file registration statements no later than 30 days after mailing by the Board of this notice of registration requirement and a copy of the registration form. All landlords shall have an additional 30 days to file the registration statement without penalty.

(c) If any landlords fail to complete and return this form within the initial 30-day registration period, their tenants may file a registration statement regarding the controlled unit on a form provided by the Board (attached as Appendix B of this regulation).

(d) Landlords who file registration statements more than 60 days after the date specified in (b) shall pay a late processing fee of $20 per unit and shall be subject to the following sanctions:

i) where the registration statement is filed on or before the ninetieth (90th) day after the date specified in sub-section (b) the effective date of any rent increase to which such landlord is entitled under Sections 600 et. seq. will be delayed six months from the date on which such increase would otherwise be operative;

ii) where the registration statement is filed more than ninety days from the date specified in sub-section (b), the effective

date of any rent increase to which a landlord is entitled under sections 600 et. seq. of these regulations shall be delayed one year from the date on which such increases would otherwise be operative.

(e) The Board shall provide tenants a copy of registration statements filed by their landlord within 10 days of receipt of such statements. Copies of registration statements shall be sent by both regular and certified mail, and shall include a notification to landlords and tenants of their right to file challenges, and that they must file such challenges within 30 days of the date of mailing of the copy of the registration statement.

Section 610 - Challenges to Registration Statements

(a) Landlords and tenants shall file written challenges to previously filed registration statements on a form provided by the Board indicating the basis for the challenge. Any party (landlord or tenant) challenging a registration statement shall pay the petition filing fee of $100 for the first unit and $20 for each additional unit in the same building. For purposes of this section, a registration statement filed by a landlord after the tenant has filed a statement shall be deemed such a challenge and shall be subject to a petition fee in lieu of a late processing fee.

(b) The Board shall conduct hearings on all challenges to registration statements in accordance with Section 852-859. For purposes of the hearings conducted to resolve disputes regarding the contents of registration statements and petitions for rent increases under Section 613 only the applicable time limits under Sections 852 and 858 shall be as follows:

i) The adverse party's time to respond to the challenge shall be 15 days from the date of the mailing of the petition;

ii) The case shall be set for a hearing within 15 days of the date the response is received or the time to respond has expired and the parties shall be afforded seven days' notice of the hearing; (see Section 8)

iii) The Board shall render its decision within 15 days of the date of the hearing. These deadlines may be extended for good cause by the Board.

(c) If a landlord and tenant cannot agree on the measurement of the square footage during the registration period and either or both parties so request, the Board shall conduct an inspection of the disputed unit, as soon as possible. The Board shall notify both the landlord and tenant at least three (3) days in advance of the inspection and of their right to be present during the inspection. If the Board conducts an inspection, the landlord and the tenant shall jointly pay an inspection fee to be determined by the Board, and shall be bound by the determination of such an inspector. The inspection procedure is in lieu of an appeal and determination by the Board.

12

Section 611 - Adjustments of October 1, 1981 Rent

(a) Within 30 days of the final resolution by the Board of any and all challenges to registration statements as provided in Section 610, the Board shall calculate the median rent per square foot as of October 1, 1981, for the regulated district (hereafter called "median 1981 rent"). This calculation shall be based on the information contained in the registration statements and any other available data, and shall be published by the Board, provided, however, that at least 50% of all units in the regulated district are registered.

(b) The Board shall publish the calculation of the median 1981 net operating income as soon as possible after their calculation.

(c) Upon written application to the Board, in accordance with Sections 853 et. seq., rents for units which are below the median 1981 rent may be raised to the median 1981 rent per square foot for the regulated district.

(d) Any rent increases allowable under this section are subject to the limitations imposed by Section 615.

Section 612 - Annual Rent Adjustment

(a) Effective the date the median net operating income per square foot is adopted in accordance with Section 611, owners shall be permitted on an annual basis to obtain rent increases designed to allow the median net operating income per square foot for the district to increase by the inflation rate (as measured by the San Francisco-Oakland Consumer Price Index) for inflation rates of 7% or less; by 7% plus one-half the inflation rate over 7% for inflation rates that are greater than 7% but less than or equal to 14%.

(b) The first increase shall be calculated according to the following formula:

$$A_1 = M \times E_1$$

Where

A_1 = the first annual adjustment of rent per square foot that owners are permitted to take when the Board of Adjustments sets the median net operating income per square foot for Elmwood Commercial properties.

M = median net operating income per square foot for Elmwood District commercial properties.

E_1 = the first Inflation Adjustment. The value of E_1 is determined by the growth in CPI between June 1982 and the CPI published just prior to the adoption of a value of M by the Board of Adjustments.

If the increase in CPI during this time is less than or equal to 7% per year, E will be equivalent to the increase in CPI. If the increase in CPI during this period is more than 7% per year but less than or equal to 14% per year, then the annual adjustment is equal to 7% plus one-half the percentage increase greater than 7%.

(c) Subsequent annual increases shall be calculated on the anniversary of the first rent increase according to the following formula:

$$A_n = (M + \Sigma A_{1,2,3...(n-1)} \times E_n$$

Where A_n = annual adjustment per square foot in year n

$A_{1,2,3...(n-1)}$ = sum of all previous annual adjustments

n = the year in which the calculation is made; n=1 on the date when the Board of Adjustments adopts the calculation of median net operating income per square foot for the Elmwood Commercial District. n will equal 2 on the first anniversary of the adoption date, n=3 on the second anniversary and so forth (n=0 on June 1982, the date of adoption of the Ordinance; this case is described in 612(b)).

M = median net operating income per square foot of Elmwood District commercial properties. This amount will be determined by the Board of Adjustments.

I_n = CPI for year n.

E = Inflation Adjustment

The value of E is determined by the annual growth in CPI during year n whenever $n > 1$. There are two separate cases:

Case 1: where the growth in CPI $\leq 7\%$,

$$E = \frac{I_n - I_{(n-1)}}{I_{(n-1)}}$$

Case 2: where $7\% <$ growth in CPI $\leq 14\%$

$$E = 7\% + \frac{\frac{I_n - I_{(n-1)}}{I_{(n-1)}} - 7\%}{2}$$

$$\text{or } 7\% + \frac{I_n - I_{(n-1)} - 7\% \, I_{(n-1)}}{2I_{(n-1)}}$$

$I_n - I_{(n-1)}$ = Positive growth in CPI from CPI from previous year. (An exception occurs when n=1 and n-1=0, when the growth in CPI is measured over the period from adoption of the Ordinance to whenever the Board sets a value of M, a case described in 612(b)).

Where $I_n - I_{(n-1)} \geq 0$. Where $I_n - I_{(n-1)} < 0$, let $I_n = I_{(n-1)}$

Where a landlord chooses to "bank" or defer application of the annual adjustment, the formula will be used to calculate successively each year's increase.

(d) Any rent increases allowable under this section are subject to the limitations imposed by Section 615.

Section 613 - Petitions for Rent Increases

(a) No petition for a rent increase under the fair return regulations may be made until a unit is properly registered in accordance with these regulations. Landlords may register at any time, but any registration statement received after the deadline contained in Section 610 shall not be used to calculate the median base net operating income per square foot.

(b) Petitions for rent increases shall be conducted in accordance with Section 610(g).

(c) Grounds for rejection of petitions for increases in whole or in part shall include but not be limited to: an owner's violation of the ordinance, changed circumstances warranting modification of the square footage on which the increase is to be calculated, conformance with the purpose of the rent stabilization ordinance.

(d) The right to any increases granted pursuant to this section shall be retroactive to the date of the filing of the petition, subject to the provisions of the California Civil Code. In order to effectuate the purposes of this section, the Board shall allow rents to be adjusted in a manner which permits the owner rent increases for the period between the date of the filing of a petition and the date in which the increase takes effect.

Section 614 - "Banking" of the Right to Rent Increases

(a) The purpose of this section is to enable a landlord to delay maximum allowable increases in rent under these regulations, without a loss in future rents that may be charged for the unit.

(b) In the event an increase permitted under the fair return regulations is not taken by the landlord as a result of choice, or an existing lease provision or limitations under Section 612 and 615, the difference between the actual increase and fair return increase that would have been permitted may be accummulated for the purpose of calculating future permitted rent levels. (For example, if $0.05 increase is allowed in Year #1 and $0.04 increase is allowed in Year #2, the owner who does not charge a $0.05 increase in Year #1 shall be permitted a $0.09 increase in Year #2.

(c) The "banking" of rent increase rights under this section shall be conditioned on compliance with the registration requirement for the entire year for which the right to any increase is to be "banked."

(d) The Board shall send a letter to all landlords and tenants explaining the operation of the "banking" provisions.

(e) Any "banked" increases which the landlord may be accummulated for an individual unit may be applied to the rent for that unit upon vacancy of the unit by the tenant in occupancy during the time such banking occurred.

(f) All landlords shall notify new tenants in writing of the landlord's right, if any, to apply banked increases to the new rent, or to continue to bank increases accummulated under this section, prior

to the new tenancy. A landlord who fails to so notify a new tenant shall forfeit the right to apply bank rent increases to the new tenant's rent. The landlord shall explain to the tenant in writing the calculation of any such rent increases.

Section 615 - Annual Overall Rent Increase Ceiling

(a) No landlord entitled to any rent increase(s) under the Ordinance and these regulations may raise the rent for a rental unit more than 25% in any twelve-month period.

(b) Any rent increases in excess of the 25% annual overall rent ceiling in Section 615 (a) to which a landlord is otherwise entitled are deferred until the next year or years, and may be "banked" and charged during the next year or years in accordance with Section 614.

Section 851 - Time to Petition

Except as provided in Section 605(e), petitions shall be filed with the Board within the time limits set forth below.

(a) A petition to determine the validity of a particu- rent level shall be filed within 120 days of:

i) the written notice of a rent increase, required by Section 573 if the petition seeks a determination as to the validity of the increase; or

ii) the written notice of the prevailing rent required by Section 571 if the petition seeks a determination of the validity of the rent at the time the ordinance became effective; or

iii) the written notice to a new tenant required by Section 572 if the petition seeks a determination of the validity of the rent charged such a tenant.

(b) The time within which an interested party or neighborhood organization may petition the Board on its own behalf shall be 120 days from when copies of notices required by Sections 571, 572 or 573 were filed with the Board. Such an interested party, neighborhood organization, or the City of Berkeley may petition the Board on behalf of a tenant, if such tenant has failed to petition the Board within the time prescribed. Any such petition shall be filed within 30 days of the expiration of the period for the tenant to petition.

(c) Notwithstanding any other provision of this section, a

petition to determine the validity of a particular rent level shall be filed within 5 years of the date such rent level became operative.

Section 852 - Filing the Petitions

Except as provided in Section 610, petitions filed before the Board shall be subject to the procedures set forth below.

(a) Any landlord, tenant, interested party or neighborhood organization seeking a determination from the Board as to the validity of rent charged or proposed to be charged shall complete a petition on forms provided by the Board to which shall be attached all supporting documents to be relied on by the petitioner at the hearing. An original and 12 copies of the petition and attachments shall be filed with the Board along with stamped envelopes addressed to each adverse party along with the filing fee set by the Board. In the case of a landlord petition, the tenant of each affected unit shall be deemed the adverse party. In the case of a tenant petition, the landlord of the affected unit shall be deemed the adverse party. In the case of a petition by an interested party or neighborhood organization, both the landlord and the tenant of the affected unit shall be deemed the adverse party. Upon receipt of a satisfactorily completed petition, the Board shall mail a copy of the petition to each adverse party by certified mail.

(b) Within 30 days of the date of the mailing of such a notice, each adverse party shall file a response to the petition to which shall be attached all supporting

documents to be relied on at the hearing by the respondent(s). An original and 12 copies of the response(s) shall be filed with the Board of Adjustments along with the stamped envelopes addressed to each adverse party.

Section 858 - Decision by the Board

(a) The decision of the Board shall be by a majority of the Board, shall be in writing and, except as provided in Section 610, shall be rendered within 45 days of the date of the hearing and shall be mailed to the parties.

(b) If the Board finds a rent level to be in excess of the limits imposed by the Ordinance, it shall adjust the rent downwards effective 30 days from the date of the mailing of the notice. Such adjustment shall provide for and schedule reimbursement to the tenant for any overpayments in rent.

(c) The decision of the Board shall be final and binding on the thirthieth day after the date it is mailed but may be reviewed by a court of competent jurisdiction pursuant to Code of Civil Procedure Section 1094.5.

(d) The prevailing party shall be awarded as costs reasonable legal accounting or filing fees incurred in connection with the proceeding before the Board provided, however, that the Board may in its decision stipulate the manner in which such costs awarded may be recovered. For purposes of determining an award of attorney's fees, the determination of who is a prevailing party shall be made in accordance with Section 11E of the Ordinance.

FINAL RECOMMENDATIONS: FAIR RETURN STANDARDS UNDER ELMWOOD COMMERCIAL RENT CONTROLS

Kenneth Baar and Dennis Keating

February 24, 1983

Prepared for the Berkeley Board of Adjustments

Introduction

This memo is the fourth in a series of reports to the Board of Adjustments on fair return standards under Berkeley's commercial rent stabilization ordinance.[1/] The first and second reports (November 10, 1982) discussed the pros and cons of the alternate fair return standards that have been used under rent controls and the operation of New York City commercial rent controls, which were in effect between 1945 and 1963. A third report (December 6, 1982), in response to the request and comments of the fair return standards subcommittee of the Board, discussed the various issues associated with the adoption of our recommended "maintenance of net operating income" fair return standard. Under a maintenance of net operating income standard, owners have the right to maintain base period net operating income.[2/] The third report also included the results of a survey of Elmwood commercial tenants' rental history and owners' rental income and operating costs and financing.[3/]

Our recommendations address the following issues which were raised in our memoranda to the subcommittee, meetings with the public, and meetings with the Board subcommittee:

1) Base Rent Period;
2) Fair Return Formula (Maintenance of Net Operating Income);
3) Adjustment of Base Rents;
4) Ceilings on Rent Adjustments;
5) Eligibility Criteria for Rent Adjustments;
6) Indexing Net Operating Income for Inflation;
7) Banking of Rent Adjustments; and
8) Process for Board review of landlord applications for fair return rent adjustments.

In response to the third report, there were owner criticisms that the maintenance of net operating income standard (fully indexed for inflation) increased differences in present rents among owners by giving the largest rent increases to owners with the highest base date net operating incomes. (For example, if there was 10% inflation, an owner with a $0.70/sq. ft. net operating income would be allowed a $0.07/sq. ft. increase while an owner with a $0.40/sq. ft. net operating income would only be allowed a $0.04/sq. ft. increase. Under this type of standard, in each subsequent year the difference in the rents allowed to each owner would increase because of the widely varying rents in the Elmwood district (ranging from 15¢ to $1.17 sq. ft. according to our survey).

In response to this criticism, we recommend a system under which uniform annual rent increases per square foot are permitted. A system of this type is feasible under Elmwood commercial rent controls (whereas such a system is not normally feasible under residential rent controls because of the large number of controlled rental units).

1/ Review of these previous memoranda is essential to a full understanding of the recommendations contained in this report.

2/ "Net operating income" is gross rent minus operating and maintenance expenses (not including debt service).

3/ Only 22 of approximately 80 tenants responded to the survey and only 2 of 23 owners responded within the one month survey period.

We also recommend some adjustment of base period rents which are below the average for the regulated district as long as such adjustments do not substantially conflict with the basic purpose of Measure I, which is to "stabilize" existing rents.

This report, in addition to detailing our final recommendations, contains proposed regulations designed to implement the proposed standard. (Appendix B). The final results of our survey (to which approximately 60% of the tenants finally respond) are reported in a supplementary memo.

Summary of Fair Return Recommendations

1) A rent adjustment designed to prevent erosion of each owner's net operating income (NOI) should be provided on an annual basis. Said adjustment shall be calculated by multiplying the "mean" (average) base net operating income per square foot for the Elmwood district by the annual increase in the San Francisco-Oakland area Consumer Price Index (C.P.I.). For example, if the mean base NOI is $0.45/sq. ft. and the inflation rate is 10%, an increase in NOI of $0.045/sq. ft. would be permitted for all Elmwood commercial properties. The actual adjustment would vary according to each store's square footage.

2) The calendar year 1981 should be used as the base period for the purpose of defining fair net operating income.

3) Adjustment of the base year rent up to the mean 1981 rent level for the Elmwood district, subject to the restriction that increases pursuant to this provision in any one year shall not exceed 20% of the base year rent.

4) Registration of base period rents within a maximum of two months of the adoption of the regulation.

5) Annual fair return increases shall not be conditioned on code compliance.

6) "Banking"--owners shall retain the right to increases allowed under the fair return regulation in the event the right is not exercised in the year the increase is permitted.

Base Period

It is necessary to choose a common "base" year to determine the average "base" net operating income, even though some Elmwood landlords will not be covered by rent stabilization until their current leases expire. The calendar year 1981 should be used as the base period.

1981 is preferable because it is the most recent year prior to the adoption of Measure I. 1982 is not a possible choice because of the adoption of in June 1982, which affected rents during this year. October 1, 1981 should be the base rent date.

Registration of the Base Period Net Operating Income (NOI)

All Elmwood owners should be required to register their 1981 base NOI with the Board. It is essential that owners register with the Board in order to apply our recommended fair return standard. The registration statement would be relatively simple.

Each owner would be required to complete a registration statement which would specify for the year 1981:

1. Tenant;
2. Rent (as of December 1981) (excluding any residential rent);
3. Operating and Maintenance expenses (paid by owner) (not including debt service and unamortized capital improvements); and
4. Square footage--interior floor space with common areas apportioned among actual tenant users.

Each owner should be also required to submit a copy of the 1981 lease.

A sample registration statement is attached to the draft regulation.

This 1981 information should be readily available to landlords (the I.R.S. requires landlords to keep their tax records for a minimum of three years). If the present owner was not the owner in 1981, this information should be obtained from the former owner, if available. If not, the tenant may be able to provide all necessary information except for the owner's operating and maintenance expenses.

Since any adjustments of the base period NOI and the annual fair return increase are based upon the rent per square foot (see explanation below), it is essential that owners be required to register their square footage.

Those owners who will not be covered by Measure I until their current leases expire should still be required to register in 1983 to avoid any future disputes over the 1981 base year NOI.

Owners should be required to file their registration statement within two (2) months (30 days, with an additional 30-day grace period) after the Board's adoption of fair standard regulations and the issuance of the registration statement forms.

The Board should send a copy of every owner's registration statement to their tenants and inform the tenants of their right to challenge the statement.

If the owner fails to file the registration statement within the first 30 days, then the owner's tenant should be allowed to file during the following three months a statement indicating the 1981 rent, square footage, and expenses paid by the tenant. A sample registration statement is attached to the draft regulation. Owners would be allowed to file statements during the next 2 months also if they had not already done so previously. However, if owners fail to file during the first 30 days, they shall be subject to a loss of six months of rent increases for statements filed more than 30 days late, and one year in rent increases if the statements are filed more than 60 days late.

If the owner and tenant jointly agree in writing on the information contained in the owner's registration statement, then there shall be no challenge.

If the owner and the tenant cannot agree on the measurement square footage, then the Board shall conduct an inspection after prior notice to both the owner and the tenant of the time and date of the inspection, in lieu of an appeal. The owner and tenant shall jointly share the expense of an inspection fee to be determined by the Board. If either party claims "special circumstances," they can appeal the square footage to the Board.

The Board should conduct hearings under Section 8(c) of Measure I to resolve any conflicts between owners and tenants over the validity of registration statements. Owners should be required to provide documentation to support any challenged registration statements. Any petitioner (owner or tenant) must pay the required petition fee.

Any challenges by tenants in the same building with common ownership should be consolidated. Hearings should be conducted in accordance with Board regulations, with the exception of shorter deadlines.

The Board should review and decide all challenges within one month of the hearing. We anticipate that the most common disputes will concern operating and maintenance expenses and special circumstances concerning square footage. However, the inspection provision should resolve most measurement disputes.

Once the Board resolves all appeals, it shall calculate the 1981 mean (average) NOI per square foot based upon the registration statements and other available information. If both an owner and tenant fail to file a statement, that store will not be included in that average calculation. Any statements filed after these deadlines shall not be used to revise the 1981 base mean NOI per square foot. If only a tenant files a statement, then the Board may presume that their owner's operating and maintenance costs have the same costs per square foot as that of the statements actually filed by landlords. However, the Board should not calculate the 1981 mean NOI until at least 50 percent of the regulated units are registered so that it is sufficiently representative.

In calculating the mean NOI, the Board shall not include any base rent adjustments allowable under the provision allowing for an adjustment of some base rents (see below).

Owners not covered by Measure I until their current leases expire who fail to file a timely registration statement should not be allowed to charge tenants retroactively a fair return rent increase to which they would be otherwise entitled for the period during which they failed to file (see "penalty" section).

Owners who are covered should not be entitled to apply for or receive a fair return rent increase (or base rent adjustment) unless they have filed a valid registration statement (again, see "penalty" section).

Adjustment of "Base" Rents

Under Section 5(b)(iii) of Measure I, owners with fixed rent leases who have not increased their rents in the year prior to June 1982, are allowed a 5 percent rent increase for each year that rents have not been increased. (For example, if rents have not been increased since 1977, a 20 percent rent increase would be allowed.) This provision excludes owners who have made even very low increased in 1981-1982, from obtaining increases for prior years during which they may not have increased the rent. Also, because it is a flat percentage adjustment, it gives the smallest increases to owners with the lowest rents.

Due to the long-term nature of commercial tenancies and leases, wide disparity among Elmwood rents results from differing patterns of leases, ownership, and related factors. The 1981 base rent per square foot should be increased if it is below the 1981 mean rent per square foot in Elmwood.

Our survey indicated that the 1981 mean rent per square foot was $0.56.

The rent was below that mean for 18 of the 31 respondents. Only after completion of the filing and any necessary review of challenged registration statements could the Board determine what this figure would actually be. Our survey does suggest that, after any other adjustments allowed by Measure I, many owners would be entitled to a base rent adjustment. Some owners would be entitled to very substantial rent increases. Those owners whose 1981 rents exceeded the mean would not, of course, be entitled to any base rent adjustment, with the exception of any adjustment otherwise provided by the Ordinance.

This base rent adjustment would be allowed only after the filing of an application by an owner after the Board issues its calculation of the 1981 mean base NOI per square foot. The tenant could challenge the application if the tenant believes that the owner's claim for an adjustment is not valid because of inaccuracies in the registration statement.

In order to protect tenants against abnormally high base rent adjustments, in accordance with the view of the Subcommittee, it is recommended that the Board limit such an increase to 20 percent of the 1981 base rent annually. If any owner is entitled to an additional increase, the remainder should be phased in during succeeding year(s) (see example below).

Annual Rent Increases

As indicated in our previous reports, Measure I only allows for a passthrough of operating income. We believe that, in order to meet the fair return requirements of the California Supreme Court as set forth in Birkenfeld v. Berkeley required by Measure I, the Board's regulations should allow for annual maintenance of the mean base net operating income. The fair return standard should also be understandable and as simple as possible to administer.

Therefore, we recommend that, in addition to the operating cost passthrough, already allowed under Section 5(c), owners be permitted an additional annual rent adjustment equal to the mean base net operating income/square foot for the Elmwood district multiplied by the inflation rate. Our survey indicated a mean 1981 rent/sq. ft. of $0.56. Assuming that NOI is equal to 80% of gross rent, the mean NOI/sq. ft. would be $0.45/sq. ft. Therefore, 10% annual inflation would justify a $0.045/sq. ft. rent increase. The actual annual increase would vary according to the size of the store (our survey indicated that the size of stores ranged from 220 to 4,121 square feet).

Since no fair return adjustments have been allowed since Measure I was enacted in June 1982, it is recommended that the first annual adjustment take into account the increase in the C.P.I. from June 1982 to the date when fair return adjustments are first permitted. It is recommended that the Board use one single C.P.I. figure so that there is no discrimination in adjustments due to fluctuations in the bi-monthly C.P.I. If feasible, the Board should use the December C.P.I. beginning in December 1983. This would allow owners to apply for and receive annual fair return adjustments every January. In December 1982, the C.P.I. did not increase at all; in comparison, in December 1981, it increased by 15.3%.

Since Measure I is already based in part on the San Francisco-Oakland C.P.I. (Section 4(f)), it is recommended that this be used to index mean base NOI. As previously indicated, in January 1983, the U.S. Bureau of Labor Statistics revised the C.P.I. (to correct for overweighting of homebuyer's mortgage costs).

In accordance with the view of the Subcommittee, we do not recommend that a ceiling be imposed on the indexing of the mean base NOI. If the C.P.I. increases as of the adjustment date, then the mean base NOI will be fully adjusted for inflation.

We do not recommend that owners' eligibility for a fair return rent increase be conditioned on building code compliance until the Board has more information concerning this issue. The Board needs to know which codes apply to Elmwood's commercial buildings, to what extent serious violations (attributable to owners) currently exist, and to what extent the conditioning of eligibility on this basis would affect Elmwood owners and tenants.

The following examples are designed to illustrate the combined effects of the base rent adjustment and annual fair return rent increase standards. (These increases are in addition to operating cost passthroughs.)

Assumptions:

1. Mean base 1981 rent for Elmwood district - $0.56/sq.ft./month
2. Mean monthly NOI/sq.ft. = $0.45
3. Increase in C.P.I. = 10%
4. Unit area = 500 sq.ft.

Hypothetical #1:

- Rent = $1.00/sq.ft. ($500)
- Increase permitted-
  a. annual rent adjustment-
     10% x $0.45 x 500 - $22.50/month
  b. base rent adjustment-
     none (because base rent exceeds mean)
  c. total increase permitted =
     $22.50/month

Hypothetical #2:

- Rent = $0.50/sq.ft. ($250)
- Increase permitted-
  a. annual rent adjustment-
     10% x $0.45 x 500 = $22.50/month
  b. base rent adjustment-
     $0.06/sq.ft. (difference between mean and rent charged ($0.56-$0.50))
     $0.06 x 500 = $30.00/month (=12% increase)
  c. total increase permitted (a&b) - $52.50/month

Hypothetical #3:

- Rent - $0.36/sq.ft. ($180)
- Increase permitted -
  a. annual rent adjustment -
     10% x $0.45 x 500 - $22.50

  b. base rent adjustment-
     $0.20/sq.ft. (difference between mean rent and rent charged
     $0.56-$0.36)
     $0.20 x 500 = $100/month (= 56% increase)

     This increase is subject to 20% ceiling on annual rent adjustment under this provision. In this case the annual ceiling is $36 (.20 x $180).

The balance may be phased in over the two subsequent years ($36 in the second year and $28 in the third year).

c. Total rent increase permitted (a&b) = $48.50/month

As these three examples indicate, if the store size is identical, rent increases will vary depending upon whether the owner is eligible for an initial base rent adjustment and, if so, whether the base rent adjustment ceiling (20%) applied.

In all three examples, assuming that 20% of the rent equals operating and maintenance expenses paid by the owner, if the costs increase by 10%, then the owner is already entitled to pass on to the tenant this increased expense in order to maintain net operating income.

The actual rent increase will vary according to the size of the store (unit area). Using the same assumptions but applying the rent increase to larger and smaller stores, the results would be:

Hypotheticals #1-2-3: (500 sq.ft. x $0.45 x 10%) = $22.50/month

Hypothetical #4: (unit area - 1,000 sq. ft. x $0.45 x 10%) = $45/month

Hypothetical #5: (unit area - 250 sq.ft. x $0.45 x 10%) = $11.25/month

This standard is objective, easy to understand, and simple to administer.

Each December, after the issuance of the San Francisco-Oakland C.P.I., the Board would issue an order indicating the uniform fair return increase. Owners could then apply for the increase. Unless a tenant disputed the owner's right to the increase, the landlord would be automatically entitled to any allowable increase. Tenants could challenge an owner's petition on the ground that the owner has not filed a registration statement or that there are changed circumstances (e.g. reduction of rented space) or any other relevant factors to be determined by the Board.

The Board should be able to review owners' petitions within 30 days. The owner would be entitled to charge the tenant effective as of the date of the filing of the petition, apportioning it over the remainder of the year, after giving the tenant the required 30 days notice of the rent increase once it is approved by the Board.

The following schedule, if feasible, is recommended for the first annual fair return increases and base rent adjustments.

1983

April	-	Board adopts fair return regulations
May-August	-	Owners (and tenants) must file registration statements
September	-	Tenants can file challenges to owner registration statements and vice versa
July-December	-	Board reviews and decides all tenant challenges
December	-	U.S. Bureau of Labor Statistics issues December 1983 C.P.I.
	-	Board calculates mean base NOI and announces 1984 fair return rent increases (June 1982-December 1983)
	-	Owners can apply for fair return rent increases and eligible owners can also apply for base rent adjustment.

1984

January - Owners can charge first annual fair return rent increases.

Banking of Fair Return Rent Adjustments

The subcommittee favored the inclusion of a "banking" provision. If an owner does not take a permissable rent increase within a particular year, that owner shall have the right to take that increase in future years.

The principal argument for banking is that it gives landlords the option of not raising rents in a particular year, without losing the right to the increase in future years. Without such a right, owners would be penalized for not raising rents as frequently as permitted. The argument against such a provision is that it may cause future confusion or lack of knowledge as to legal rent levels. Also, it may lead to very substantial rent increases in future years. One possibility is to place a time limit on such increases. For example, all increases musi be taken within three to five years of the time that they are originally permitted.

It is recommended that in instances where rent increases allowed under current leases, exempt from Measure I until their expiration, are less than the increases allowed under the annual rent increase provision of the fair return regulations, the owner should be allowed to "bank" the difference between the two increases. For example, if a lease restricts rent increases to $0.02/sq.ft. and a $0.05/sq.ft. increase is allowed under the annual rent adjustment provision, the owner would be allowed to "bank" a $0.03/sq.ft. increase until the termination of the lease.

Failure to register should result in a loss of the right to "banking" of any increases permitted during the period in which the owner failed to register. Owners should also be required to notify tenants of the owner's election to bank rent increases (with loss of the banked rent increase as a penalty for non-disclosure).

APPENDIX A

Elmwood Owner's Registration Statement (Draft)

A. Owner (Current)

Name _____

Address _____

_____

Managing Agent (if any) _____

_____

_____

Telephone ( ) _____

1981 Owner (if different from current owner)

Name _____

Address _____

_____

B. Tenant (1981)

Name _____

Address _____

_____

_____

C. Rent (monthly)

October 1, 1981 $ _____

D. Operating and Maintenance Expenses (1981)

(N.B. Do not include debt service or unamortized capital improvements)

Please itemize. Only list expenses paid by owner in 1981.

a) Property Taxes $ _____

b) Building Maintenance $ _____

c) Building Repairs $ _____

d) Insurance $ _____

e) Utilities

Water $ _____

Sewer $ _____

Gas $ _____

f) Garbage $ _____

g) Other (please explain) $_____

Total (1981) $_____

Total ÷ 12 months $_____/month

E. Square Footage
(N.B. Only list space rented to tenant as of October 1, 1981)

_____ square feet

F. Lease

(Attach copy of 1981 lease)

G. Comments

_____
(Owner's Signature)

_____
(Date)

_____
(Tenant's Signature)

_____
(Date)

APPENDIX B

Elmwood Tenant's Registration Statement (Draft)

A. Tenant (Current)

Name _____
Address _____
Telephone _____

1981 Tenant (if different from current tenant)

Name _____
Address _____

B. Owner

Name _____
Address _____
Telephone ( ) _____

C. Rent (monthly)

October 1, 1981 $_____

D. Operating and Maintenance Expenses 1981

Please Itemize. Only list expenses paid by tenant in 1981.

a) Property Taxes $_____

b) Building Maintenance $_____

c) Building Repairs $_____

d) Insurance $_____

e) Utilities

Water $_____

Sewer $_____

Gas $_____

f) Garbage $_____

g) Other (Please explain) $_____

Total (1981) $_____

Total ÷ $_____/month

E. Square Footage

(NIB. Only list space rented as of October 1, 1981.)

F. Lease

(Attach copy of 1981 Lease)

G. Comments

_____
Tenant's Signature

_____
Date

ELMWOOD LANDLORD AND TENANT SURVEY

Supplementary Report to Berkeley
Board of Adjustments

BY

KENNETH BAAR AND DENNIS KEATING

February 14, 1983

On October 1, 1982, a questionnaire was sent to each Elmwood commercial property owner requesting information by November 5, 1982 about: purchase price, rent levels 1978 - 1982, 1980 and 1981 expenses and income, financing, and capital improvements. A letter accompanying the survey form requested that as much information as is readily available be supplied, in the event that not all of the information requested was easily available. Anonymity for all respondents was guaranteed.

In early November landlords were contacted by telephone in an attempt to gain their cooperation, since none of the survey forms had been returned. Only two of the 23 owners completed and returned the questionnaire by December 3, 1982.

A survey questionnaire was also sent to each tenant, requesting information about: original date of tenancy, commencement and termination of the current lease, rent lvevel 1978-present, expenses paid by owner and tenant, capital improvements, and changes of ownership of the property. Twenty-two of approximately 80 tenants completed and returned the questionnaires by December 3, 1982. The results of the survey were reported in our December 6, 1982 memorandum.

Additional responses were requested. By January 21, 1983 another 28 tenants had responded for a total of 50 (approximately 60%). Only one other landlord responded. The three landlord responses (13%) were incomplete and were not tabulated.

The overall results of the tenant survey are reported. Total responses to particular responses vary because not all tenants responded to every question.

Table 1

Elmwood Leases

Original Date of Tenancy	Tenants
1940 or earlier	3
1941 - 1949	2
1950 - 1959	2
1960 - 1969	11
1970 - 1974	6
1975 - 1979	9
1980 - 1981	8
1982	5

Current Lease

Commencement	Tenants
1964	1
1977	5
1978	2
1979	4
1980	4
1981	8
1982	8

Expiration	
1982	4
1983	8
1984	9
1985	3
1986	1
1987	3
1990	3
1991	2
1992	1

Term	
Month-to-month	7
Two years	6
Three years	4
Four years	2
Five years	8
Nine	5
Ten years or more	3

How Rent Set	
Fixed Rent	21
Consumer Price Index Escalator	11
Property Tax Escalator	4

Table 2

Responsibility for Expenses

Expenses	Paid by Owner	Paid by Tenant	Shared
Electricity	2	40	
Gas	2	38	
Water	9	32	
Sewer Treatment and Maintenance	9	26	
Trash	5	37	
Insurance (Fire/Liability)	15	24	
Operating, Maintenance and Repairs	12	21	5
Property Taxes	18	16	1

Table 3

Mean Rents (per square foot) (1980-82)

1980	1981	1982
$0.51	$0.56	$0.69

This data is based upon 31 responses. The stores ranged in size from 220 to 4,121 square feet. In 1981, 18 of the 31 tenants' rent was below the mean. In 1981 rents per square foot ranged from a low of $0.15 to a high of $1.17.

In 1982 rents per square foot ranged from a low of $0.15 to a high of $1.32. The following compares our survey with that conducted by Blayney-Dyatt for the City of Berkeley.

Table 4

Baar - Keating (41 respondents)	Blayney - Dyatt	
% Respondents	% Respondents	Rent/Square Foot
22	-	$0.50 or less
56	28	0.75 or less
27	25	0.76 - $1.00
17	10	1.01 - $1.50
0	3	1.50 - or more

Rent Increases

Twenty-eight tenants provided information concerning rent increases between 1978 and 1981. Twenty reported rent increases, cumultatively averaging 39.1%. Including the eight tenants who reported no rent increases, the cumulative average rent increase was 27.9%. During this same period (January 1978 - December 1981) the San Francisco - Oakland Comsumer Price Index (CPI) increased by 45.1%.

Table 5

Cumulative Average Rent Increases (1978 - 1981)

Number of Units	Cumulative Rent Increase %
12	0 - 9.9
2	10 - 19.9
6	20 - 39.9
5	40 - 59.9
1	60 - 79.9
0	80 - 99.0
2	100 - or more

The following table indicates the average percentage rent increases for those units which reported rent increases between 1979 and 1981:

Table 6

Average Percentage Rent Increases

(only for units reporting rent increases) 1979-1981)

	1979	1980	1981
Number of Units reporting rent increase	9	15	21
Unweighted average percentage rent increase	11%*	16.8%	17.5%
Percent Increase (San Francisco - Oakland CPI - All Items)	8.5%	15.2%	12.8%

*Two tenants reported decreases averaging 4.6%.

The survey also indicated that 23 tenants received rent increases averaging 41.3% in 1982. If three extraordinarily high rent increases in excess of 100% are excluded, the remaining 20 averaged 18.8%. This data only indicates those rent increases up to the date of passage of Measure I in June 1982.

DATE: November 10, 1982

TO: Berkeley Board of Adjustments

FROM: Kenneth Baar and Dennis Keating

RE: Memos on Fair Return Standards Under Rent Controls

Two memos are enclosed. One contains a general discussion of legal and conceptual issues relating to alternate types of fair return standards that have been used under rent controls. Questions about this memo should be addressed to either Ken Baar or Dennis Keating. The other memo discusses fair return standards under New York City rent controls, which were in effect between 1945 and 1963. Questions about this memo should be addressed to Dennis Keating.

Presently, a survey designed to obtain operating expense and income information about the registered units is underway. After that survey is completed (mid-November) and a meeting with the subcommittee of the Board is held (now scheduled for November 15), a follow-up memo will be prepared in response to questions raised by board members and staff. Also, it will incorporate the information obtained from the survey. The memo will, to the extent possible, indicate the specific impacts of alternate fair return standards on the regulated properties.

In the meantime, we hope that these memos are clear, informative, and provide answers to your questions. In the event that you desire further clarification or information, you may call us.

would justify market rate rental prices. These levels would exceed $1.00 per sq.ft. per month and would result in doubling the rents of a substantial percentage of the commercial units in the Elmwood. The use market values as of a date just prior to the adoption of Measure I would lead to the same results, since the values as of June 1982 are substantially the same as current values.

Market Value Defined as Value Under Commercial Rent Controls

In this case, market value would be determined by rental income allowed under the ordinance. Therefore, using value to determine what rents would be permitted would become a completely circular process, in which the current rent would determine the permissible rent for a fair return.

Return on Investment

As expected, investments in Elmwood properties, as measured by purchase price, vary drastically according to the date of purchase. The limited data on purchases within the last few years indicates purchase prices of $70 to $100 per sq.ft. of improvements. In contrast, purchasers in the mid-1970s were paying $40 to $70 per sq.ft. In the early 1970s, prices were in the range of $20 to $40 per sq.ft. These are rough estimates because complete price and square footage information is unavailable. However, it clearly indicates that under a fair return on investment standard, recent purchasers would be permitted rents several times higher than long term owners.

If a 10% to 15% return on investment was allowed, owners who purchased in the early 1970s or before would usually not be able to obtain any fair return increases, either now or in future years. In effect, their net operating income would be frozen at current levels, even if they were charging considerably lower rents than recent purchasers. A review of the Alameda County Recorder's records indicates that half or more of the owners of commercial property in the Elmwood purchased their properties in the early 1970s or earlier.

The use of a return on investment standard would be complicated by the fact that long term owners may not know their original investment,[1] especially if their property was inherited. Also, long term owners may have no records of major capital improvements, which were made many years ago; such improvements are normally considered part of investment.

On the other hand, recent purchasers would be able to raise their rents from $0.80 to $1.40 per sq.ft. For new purchasers, the rent level would be controlled by buyers, since it would be based on the purchase price and financing terms. Therefore, the return on investment standard would act as an incentive to sell, since new owners could charge much higher rents than present long term owners.

Return on Value

Value Defined as Market Value in an Unregulated Market

Since value is determined by future rental income, the use of market value in the unregulated market as the measure of value

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[1]The two landlord forms that were completed did not include responses to the question about purchase price; one stated that purchase price was unknown.

4. Adjustment of Base Period N.O.I.

The "base period" N.O.I. which is used for the purpose of calculating the current fair net operating income shall be subject to the following adjustment. In the event that the rent for a unit was increased less than ___% between _____, 19__ and _____, 19__, that rent shall be increased by the difference between ___% and the actual rent increase during that period, in order to compute the base period N.O.I.

5. Calculation of Current Fair Net Operating Income

The current fair net operating income shall be the base period net operating income adjusted by ___% of the percentage increase in the San Francisco-Oakland All Items C.P.I. since _____.

Optional Provisions

6. Ceiling on annual allowable increases permitted under this regulation.

7. Ceiling on base period NOI adjustment increases allowed under this regulation.

8. Banking.

9. Sublessor-tenants.

V. THE IMPACT OF ALTERNATIVE FAIR RETURN FORMULAS ON ELMWOOD RENTS

In the October 10 memo, the conceptual operation of alternate fair return formulas was discussed. However, there was no discussion of the actual dollar impacts of each of the formulas. In the survey of landlords, information about debt service, purchase prices, and purchase dates was requested. However, since owners (with two exceptions) did not complete the survey questionnaire, estimates of the impact of the alternate formulas must be based on the limited evidence that is readily available from other records. Purchase prices for properties purchased after 1975 may be estimated from property taxes since, under Proposition 13, properties purchased in 1975 or later are assessed at purchase price and then increased by 2% per year.

The estimated impact of two alternate formulas (return on investment and return on value) are discussed next. In our October 10 memo, we recommended against the adoption of both formulas for the reasons indicated.

If our suggested fair return formula is adopted, then there should be no problem in granting any necessary rent increases within this deadline. Once a landlord applied (having already previously raised the rent to cover any increases in operating and maintenance expenses), assuming that the landlord has satisfactorily documented base year and current year operating expenses and rents, all that the Board is required to do is to adjust the N.O.I. by the San Francisco-Oakland C.P.I. All Items in order to calculate the current allowable rent.

Second, the Board should limit rent increases to once each calendar year. This policy is embodied in the Measure D, the residential rent stabilization ordinance, and is typical of most rent control laws.

Third, these rent increases should take effect from the date of the filing of the landlord's petition.

Fourth, the landlord's registered N.O.I. should be subject to a tenant challenge if the tenant believes that it is incorrect.

IV. OUTLINE OF DRAFT FAIR RETURN REGULATIONS[1]

Fair Return Adjustments

1. In order to provide owners with a fair return, they shall have the right to obtain individual rent adjustments which will allow their net operating income to increase at ___% of the inflation rate.

2. For purposes of this regulation, the net operating income obtained during the base period shall be presumed to be a "fair net operating income," subject to the exceptions set forth in Section ___ of this regulation.

3. Definitions

a. Net operating income (N.O.I.) shall be defined in accordance with Section 530 of these regulations.

b. The "Base Period" shall be 1981. If the building was vacant in 1981, the base period shall be ____.

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[1]These are draft regulations in an outline form indicating how our recommendations would be translated into Board regulations. Once the Board acts on our recommendations, these regulations can be completed.

fluctuations within such a short period were due to the fact that homeownership costs (especially mortgage interest rates) underwent substantial fluctuations. As indicated, as of January 1983, the C.P.I. All Items will be revised to more accurately reflect changes in homeownership costs of all owners rather than just first time purchasers.

If banking is not permitted, a distinction would have to be made between owners who were not permitted annual adjustments for several years, under the terms of the lease in effect, and owners who were permitted such increases under the existing lease.

Annual Ceiling on N.O.I. Inflation Adjustments

As our prior memo indicated (p.25), it may be advisable to phase in fair return rent increases which could lead to abnormally high rent increases. A purpose of Measure I was to limit such increases, at least those in excess of the C.P.I. (Section 13(b)).

Fair return rent increases could be subject to an annual ceiling. The ceiling which has typified residential rent control (e.g., Berkeley and Santa Monica) and commercial rent control (New York City) has been 15%. This, until the 1980-1981 period, has been well above the average annual inflation rate in the Bay Area. This is currently the case.

If a ceiling is adopted and the inflation adjustment exceeds that ceiling, then the landlord must wait until the following year to charge that part of the adjustment which exceeds the ceiling. For example, if a 15% ceiling is adopted and the inflation rate is 17%, the N.O.I. could only be increased by 15% that year. The landlord could charge the additional 2% N.O.I. adjustment but only in the following year (assuming that N.O.I. is fully adjusted for inflation).

Fair Return Hearing Procedures

In general, the Board's Regulations (850-859) should be applicable to petitions and hearings concerning rent increases for fair return. We would suggest the following changes.

First, the Board should declare by regulation that all landlord petitions for such rent increases will be reviewed, heard, and decided no later than 120 days after the filing of the petition, except for good cause. This is to ensure that landlords are not denied "due process" through long delays. The Berkeley Rent Stabilization Board has adopted this policy (Regulation 1243). Good cause for extension of this deadline includes mutual agreement by the landlord and tenant to extend the hearing and a landlord's failure to provide necessary information (e.g., concerning income and operating and maintenance expenses).

"Banking" of N.O.I. Inflator Adjustments

Another issue is whether a landlord should be entitled to "bank" his allowable increase because he wants to defer increasing his rent.

One option is that a landlord must either apply for, receive and charge his tenants a fair return rent increase when he is permitted (i.e., once annually) or he would lose his right to an inflator of the N.O.I.

Another option is to allow a landlord to bank allowable increases and make the increase at a time of his choosing. For example, if a landlord is entitled to a $500 increase annually in 1983 and 1984, and chooses to defer charging these increases, then the landlord could charge the cumulative increase of $1,000 in 1985.

A third option is to limit banking. If an annual rent increase ceiling is adopted, then this could restrict such cumulative rent increases to the limit and force the landlord to phase in the deferred rent increase. To limit future complications, it has been argued that landlords should be required to take deferred rent increases within a reasonable period (e.g., three to five years) or lose their right to do so. Initial registration of the base N.O.I. would obviate such future complications.

The arguments for an allowance of banking are that in the absence of such provisions, owners will always take the maximum rent increases permitted, each year, in order not to lose the right to such increases. In effect, owners who may prefer to wait for a change in tenancy to raise rents or who may want to delay institution of an increase out of special consideration for the tenant, will feel compelled to make increases in the absence of a banking provision.

The argument against banking is that it may unnecessarily complicate the rent adjustment process because landlords and tenants must carefully track all rent increases to ensure that landlords are not abusing their banking rights. It may unfairly present future tenants with substantial rent increases.

In the event that the Board does not permit banking and thereby restricts the period in which individual N.O.I. inflation adjustments are permitted (e.g., once annually), it may want to designate a limited period (e.g., a two-month period) in which petitions for such increases will be accepted and the period that will be used to measure the C.P.I. increase. Otherwise, the size of the increase allowed may vary substantially simply according to when a petition is filed. For example, from June 1981 to June 1982, the C.P.I. All Items increased by 11.2%; from August 1981 to August 1982, the increase was 5.7%; from October 1981 to October 1982, the increase was 1.8%. Part of the substantial

of the inflation rate. There is very little data on the rate of growth in net operating incomes for residential properties. There is no regularly published data on the rate of rent increases for small retail businesses. The survey of Elmwood commercial rents conducted as a part of this study indicated that, on the average, 1981 rents were 28.6% higher than 1978 rents. During this period, the San Francisco-Oakland All Items Consumer Price Index increased by 45%.

Commercial rentals in Berkeley may be distinguished from residential rentals by the fact that operating cost/rental income ratios for residential units average about 40%, while for commercial properties they probably average under 20%.

Allowing net operating income to increase at the inflation rate would result in rents increasing at nearly 100% of the inflation rate, due to the 80% or higher estimated net operating income/rental income ratios.

It is recommended that inquiries be made at the meetings with landlords and tenants as to what base period net operating income inflation adjustment (full or partial) would be considered reasonable.

The Choice of Inflation Index

The ordinance uses the Consumer Price Index -- All Items, San Francisco-Oakland area as the standard for limiting rent increases under leases which were executed between October 2, 1980 and October 1, 1981. It is recommended that the Board also use this index as the measure in adjusting base period net operating income under the fair return standard.

However, it should be noted that, in recent years, increases in the index for the San Francisco-Oakland area have been heavily impacted by increases in house prices (including mortgage interest rates) for first time buyers, which presently constitute approximately 25% of the weight of the index. For example, for the period June 1981-June 1982, the increase in the C.P.I. for the area was 11.2%. In contrast, the increase in the index for all items less shelter was 8.4%. For the period August 1981-August 1982, the increase in the index for all items was 5.7%, while for all items less shelter it was 7.5%. During the first 12 month period, homeownership costs for first time buyers increased at a faster rate than the cost of other items, while during the second period they increased at a slower rate.

In January 1983, the methodology used for calculating the C.P.I. will be revised to drastically reduce the weight accorded to homeownership costs for newly purchased homes, and therefore should be a more accurate gauge of increases in the cost of living.

Alternate Extra Increase Standards

A. Owner is allowed the difference between actual rent increases between 1978 and June 1981, and 5% per year. Under this standard, the landlord would not be allowed any "extra" increase, because Section 5 (c)1 already permits a 15% increase.

B. Owner is allowed a percentage rent increase equal to the difference between the cumulative 45% increase in the C.P.I. between 1978 and 1981, and actual rent increases. Under this standard, the landlord would be allowed a 45% ($203) increase, minus the 15% ($75) increase allowed under Section 5(c). "Extra" increase allowed: $128.

C. Alternative A or B above, subject to a percentage ceiling (e.g., 10%, 15%, or 25% maximum increase allowed pursuant to this provision).

Adjustments In Base Period Rent for Special Circumstances

Maintenance of net operating income regulations under residential rent controls typically provide for exceptions to the presumption that the base period net operating income was a "fair net operating income." Special circumstances have included: the rents were not set in an arms-length transaction (e.g., rental to a relative), base period rents do not reflect capital improvements made during the base period, and other peculiar circumstances.

Since only a fraction of the landlords and tenants completed survey questionnaires, it is difficult to determine what, if any, special circumstance exceptions would be appropriate. Furthermore, the institution of a base rent adjustment, which is not common under maintenance of net operating income standards, may be seen as a reasonable and more objective substitute for the special circumstances provisions.

Indexing Base Period Net Operating Income for Inflation

As indicated in the October 10 memo on fair return standards, most jurisdictions which have used a maintenance of net operating income standard have either allowed net operating income to increase at the full inflation rate or have not provided for any inflation adjustment in net operating income. Two jurisdictions allow net operation income to increase at approximately one-half the inflation rate.

There is no "magic" or "scientific" answer as to what rate of growth in net operating income should be permitted. Historically, U.S. residential rents have increased at about two-thirds

The following hypotheticals are designed to illustrate how such "extra" increase provisions would operate.

Hypothetical #1

The landlord is not eligible for an adjustment pursuant to Section 5(c)1, because the rent was increased 5% in September, 1981.

	1978	1979	1980	1981
Rent (Monthly)	$450	$450	$450	$500
Rent Increase		0	0	$ 50
% Rent Increase		0%	0%	11%

Alternate Extra Increase Standards

A. Owner is allowed the difference between actual rent increases between 1978 and June 1981, and 5% per year. Under this standard, the landlord would be allowed a 15% ($75) increase over the 1978 rent level (5% x 3 years), minus the 11% ($50) actual increase. Extra increase allowed: $25.

B. Owner is allowed a percentage rent increase equal to the difference between the cumulative 45% increase in the C.P.I. between 1978 and 1981, and actual rent increases. Under this standard, the landlord would be allowed a 45% ($203) increase, minus the 11% ($50) actual increase. Extra increase allowed: $153.

C. Alternate A or B above, subject to a percentage ceiling (e.g., 10%, 15%, or 25% maximum increase allowed pursuant to this provision).

Hypothetical #2

The landlord is eligible for a 15% increase pursuant to Section 5(c)1, because the rent has not been increased since May, 1979.

	1978	1979	1980	1981
Rent (Monthly)	$450	$500	$500	$500
Rent Increase		$ 50	0	0
% Rent Increase		11%	0%	0%

This provision in the ordinance addresses situations in which no rent increases were made in the years prior to 1981-198 . However, it does not address the situation in which only minimal increases were made. For example, if an owner did not increase the rents for four years, a 20% extra increase would be permitted. On the other hand, if the rents had been increased 1% during 1981 but had not been raised for three years before that increase, no adjustment would be permitted.

In order to address situations in which only minimal rent increases were made, we suggest the adoption of a standard which allows for rent increases equal to the difference by which rents were actually raised during a specified period and some designated percentage. The percentage could be 5% per year (the amount allowed under the ordinance for owners who have not made any increase) or any other percentage chosen by the Board (e.g., the Consumer Price Index, which has increased approximately 10% annually in the past four years). Under New York City commercial rent controls, when the law took effect (in 1945), landlords were allowed to raise their rents 15% over their 1943-1944 levels.[1]

A decision needs to be made about the length of the period that will be considered in calculating what extra increases shall be allowed (e.g., should rent increases be allowed to compensate for minimal rent increases over a three, five, or seven year period). Obviously, the longer the period, the greater likelihood of substantial rent increases. Also, there will be greater difficulties in regards to documentation, especially in instances where there have been changes in owners and/or tenants, Under I.R.S. regulations, owners are required to retain records for a minimum of three years.

Another issue is whether a ceiling should be placed on the amount of increase allowed under this provision. The Board might also consider limiting the extra increase calculation to a period of a few months after adoption of the fair return regulations in which all landlords eligible for this adjustment must apply for it. This would simplify the Board's work. Even those landlords not eligible for such rent increases until the expiration of their existing leases could be required to also establish during a specific period what "extra" increase they will be entitled to at the expiration of the lease in effect. The drawback of placing time limits on the period in which such an extra increase may be applied for is that such a limit might work to the disadvantage of the least knowledgeable owners.

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[1] N.Y. L.1945, C.3, Section 1 and L.1945, C.314, Section 1.

- For leases which were executed between October 1980 and October 1981, the base rent shall be the lesser of the prior rent increased by the C.P.I. or the rent specified in the lease.

It is suggested that, for purpose of defining base period net operating income under the fair return standard, a common base period (1981) should be used for all units. This base rent could be adjusted to provide an "extra" rent increase. A base rent adjustment is discussed in the following section. Selection of the base rent periods set forth in the ordinance for the purpose of applying the fair return standard would result in owners being permitted differing rates of growth in net operating income.

Registration of the Base N.O.I.

We have recommended that 1981 N.O.I. be used as base year for calculating the N.O.I. that would be allowed in future years. We recommend that all landlords be required to register their 1981 N.O.I. with the Board. They should be allowed a reasonable period (e.g., six to nine months) to do this. When a landlord applied for an increase, this registered N.O.I. would be subject to challenge by tenants if they believed that it was incorrect.

Early registration of this critical information would prevent future problems caused by the inability of landlords to supply information about their base period N.O.I. Otherwise, in cases where no petitions are made for a fair return adjustment until several years after the regulation is adopted, or in cases where a property is sold, it may be impossible to determine base period N.O.I.

Adjustment of the Base Rent and Net Operating Income

As indicated in our prior memo (pp. 24-25), there is an argument for allowing landlords to adjust their base rent pursuant to the fair return standard in instances where rent increases have been well below the norm in the years prior to the adoption of the law (see October 10 memo, pp. 24-25). Adjustments of this type are designed to avoid locking owners who have not raised rents prior to the adoption of the ordinance into rents that were in effect for years prior to the passage of the ordinance.

Measure I already partially addresses this problem by providing for a 5% increase in the "base" rent for every year that no rent increase was made since the prior rent increase in situations in which fixed payment leases were in effect as of June 8, 1982 and no rent increases had been made during the previous year.

Since the standard compares operating expenses and income for different years in calculating fair net operating income, it is not critical whether a depreciation cost is allowed. This is true because the basis for allowed increases is increased operating expenses and inflation (applied to the base period net operating income). Assuming that depreciation does not change between the base period and the time of the fair return application, it would not provide a basis for charging higher rents. In fact, inclusion of depreciation as an expense, under a maintenance of net operating income standard, would lead to a reduction in the base period net operating income which is used as a basis for calculating future adjustments.

Base Period

Under a maintenance of net operating income standard, it is necessary to establish a base period net operating income for the purpose of computing what net operating income shall be permitted when an increase application is made. Typically, rent control fair return standards of this type use a base period just prior to the adoption of rent controls, with an assumption that the net operating income obtained just prior to regulation is a "fair net operating income" for the property.[1]

Several complicating factors are involved in defining base period and base period net operating income for the purpose of Elmwood commercial rent controls:

- The law provides for different "base rent" periods for different owners. (Section 5(b)).
- For leases which were in effect on October 1, 1981, the base rent shall "be the amount of the final lawful periodic rental payment required by such lease." (Section 5(b)).
- For leases which were in effect on the date the ordinance was enacted (June, 1982) which provide for fixed rental payments (e.g., do not have an escalator clause), the base rent shall be the June 1982 rent, increased by 5% times the number of years since the last rent increase.

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[1]Some jurisdictions which have adopted a maintenance of net operating income standard use the average of the three or five year period prior to the adoption of rent controls as the base period. Usually, this type of base period is used when the standard was adopted long after the institution of rent controls, therefore making it unreasonable to require pre-rent control income data.

Maintenance of Net Operating Income
(50% of Inflation Indexing)

Base Period C.P.I. = 100
Current C.P.I. = 110

	Base Year	Current Year
Operating Expenses	1,500	1,600
Net Operating Income	8,500	8,925 (8,500x105%)
Gross Rent	10,000	10,525

Eligibility

All landlords would be eligible to file for increases under the standard, except that no one should be eligible for such an increase unless they have already increased the rent by the "allowable adjustment" (pursuant to Section 5(c)(i)), which is the amount necessary to cover operating cost increases. Landlords who entered into a lease prior to October 1, 1981, which is still in effect, are not eligible for such an increase until the lease expires, at which time Measure I applies to them. (Discussion of treatment of sublessors is reserved pending further discussion with Board.)

Definition of Net Operating Income

The standard definition of net operating income is gross rental income minus operating expenses. For the purposes of this type of standard mortgage payments are not considered to be an expense. Section 5(c) of the ordinance excludes from consideration as an operating expense increased debt service which is due to refinancing or purchase after the passage of Measure I.

Also, it is recommended that depreciation not be allowed as an expense. Depreciation is not included among allowable expenses under Measure I and is specifically excluded as an expense under Regulation 530(b)(6). If a property has depreciation which necessitates capital improvements, the landlord may increase the rent to cover the cost of the capital improvement (Regulation 531). Depreciation was not allowed as an expense under New York City Commercial Rent Control. See October 10 memo on New York Rent Control, page 9.

III. RECOMMENDATIONS AND DISCUSSION -- MAINTENANCE OF NET OPERATING INCOME FORMULA (INDEXED FOR INFLATION)

Measure I specifically provides that owners' dollar net operating income shall be maintained by granting the right to make rent increases which are adequate to cover increased "maintenance and operating expenses, property taxes, fees, and improvements." (Section 5(c)(i)).

Section 6(a) provides that landlords shall not be denied any constitutional right to a fair return that they may have. Section 6(b) states that landlords shall be allowed to individually petition the Board in order to obtain a fair and reasonable return on investment. Section 6(c) requires the Board to adopt fair return regulations.

For the reasons set forth in our memo of November 10, we recommend that the Board adopt a maintenance of net operating income formula which is indexed for inflation, pursuant to its authority to adopt a fair return standard. Under such a formula, owners would be allowed annual rent increases which would provide for growth in net operating income at a designated percentage of the inflation rate.

As indicated in our memo, the type of fair return standard that is recommended has been used by Massachusetts rent controlled cities. Under the Massachusetts standard, the net operating income yielded by the property during a base period, just prior to the adoption of rent controls, is presumed to be a "fair net operating income" and owners are entitled to increases in net operating income equal to all or a portion of the inflation rate.

The following hypotheticals are designed to describe the basic operation of the standard using full and partial (50% of inflation) indexing of n.o.i. during a period of 10% inflation.

Maintenance of Net Operating Income (100% of Inflation Indexing)

Base Period C.P.I. = 100
Current C.P.I. = 110

	Base Year	Current Year
Operating Expenses	1,500	1,600
Net Operating Income	8,500	9.350 (8,500x110%)
Gross Rent	10,000	10,950

The following table indicates the average percentage rent increases for those units which incurred rent increases between 1978 and 1981.

Table 4

Average Percentage Rent Increase

Only for Units Reporting Increases

1979-1981

Year	1979	1980	1981
No. of Units Reporting an increase	5	8	10
Unweighted Average Percentage Increase	9.3%*	16.6%	23.4%
Percentage Increase C.P.I. - all items	8.5%	15.2%	12.8%

*Two tenants reported decreases averaging 4.6%.

The survey also indicated that in 11 cases, 1982 rent levels were higher than 1981 rents. The average increase was 27%. However, if one exceptional increase is excluded from the average, it is reduced to 16%. Under the terms of the ordinance, increases pursuant to leases which were executed prior to October 1, 1980 remain in effect (Section 13(b)). However, rent increase provisions in leases executed between October 1, 1980 and October 1, 1981 are subject to a percentage ceiling equal to the percentage increase in the C.P.I. (The data does not necessarily indicate what rent increases would have been made if the rent control ordinance had not been adopted.)

Ratio of Operating Expenses to Gross Rental Income

Since only two of approximately 20 owners responded to the questionnaire, general statements cannot be made about the ratio of landlords' operating expenses to rental income. However, it should be noted that the two statements that were returned indicated ratios of less than 20%, which was consistent with the tenant statements, which indicated that they pay for most expenses.

Table 3

Rent Levels Per Square Foot

No. of Tenants	Rent/Sq.Ft.
7	$ .50 or less
1	$ .50 - .75
2	$ .76 - .99
3	$1.00 or more

In comparison, 38.5% of 83 Elmwood businesses responded to a 1982 survey conducted by Blayney-Dyatt for the City. The reported patterns were:

% Respondents	Monthly Rent/ Sq.Ft. Range
28	$ .75 or less
25	$ .76 - $1.00
10	$1.01 - $1.50
3	$1.50 or more

Rent Increases

On the average, 1981 rents were 28.6% higher than 1978 rents. During this same period, the C.P.I. increased by 45.4%.

No. of Units	1978-1981 Cumulative Rent Increase (%)
5	0 - 9.9
1	10 - 19.9
5	20 - 39.9
2	40 - 59.9
2	60 - 79.9
	80 - 99.9
1	100

Table 2

Expenses	Paid by Owner	Paid by Tenant	Share
Electricity	2	15	
Gas	2	15	
Water	5	12	
Sewer Treatment	5	11	
Sewer Maintenance	4	12	
Trash	2	15	
Insurance (Fire & Liability)	7	10	
Operating, maintenance, and repairs	7	6	3
Property Taxes	9	6	1

Table 1

Responses to Tenant Survey

Original Date of Tenancy

1940 or earlier	2
1941-1949	1
1950-1959	1
1960-1969	4
1970-1974	4
1975-1979	7
1980-1981	2

Current Lease

Commencement

1964	1
1977	5
1978	1
1979	3
1980	2
1981	3
1982	1

Expiration

1982	4
1983	5
1984	5
1990	1

Term

Month-to-Month	5
One year	
Two years	
Three years	2
Four years	1
Five years	7
Nine years	1

How Rent Set

Fixed	13
Consumer Price Index Escalator	6

I. INTRODUCTION

On November 10, 1982, the authors prepared two memoranda for the Board of Adjustments. One contained a description of the alternate fair return standards that have been used under rent controls and a discussion of legal and conceptual issues regarding those standards. The other memo discussed the operation and judicial consideration of New York City commercial rent controls, which were in effect between 1945 and 1963.

On November 15, a meeting was held with a subcommittee of the Board of Adjustments. At that meeting, the subcommittee indicated that it wanted to obtain specific recommendations regarding a maintenance of net operating income formula (indexed for inflation) and a draft of a maintenance of net operating income fair return regulation.

Also, in October and November, a survey of Elmwood landlords and tenants was conducted in order to determine rent levels, expenses, commencement of tenancies, lease terms, and other related information.

The purpose of this memo is to discuss issues involved in drafting maintenance of net operating income standards, the survey results, and other related questions.

II. SURVEY RESULTS

On October 1, a questionnaire was sent to each Elmwood commercial property owner requesting information by November 5 about: purchase date, purchase price, rent levels 1978-present, 1980 and 1981 expenses and income, financing, and capital improvements. A letter accompanying the survey form requested that as much information as is readily available be supplied, in the event that not all of the information requested was easily available. Anonymity for all respondents was guaranteed.

In early November landlords were contacted by telephone in an attempt to gain their cooperation, since none of the survey forms had been returned. Only two of the 23 owners completed and returned the questionnaire by December 3.

A survey questionnaire was also sent to each tenant, requesting information about: original date of tenancy, commencement and termination of the current lease, rent levels 1978-present, expenses paid by owner and tenant, capital improvements, and changes of ownership of the property. Twenty-two of approximately 80 tenants completed and returned the questionnaires. (The survey forms are included in Appendix A.)

The tenant survey responses are tabulated in the following tables. Not all of the questionnaires were completely filled out. Therefore, total responses to particular questions vary.

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RECOMMENDATIONS AND DISCUSSION OF A FAIR RETURN FORMULA UNDER THE ELMWOOD COMMERCIAL RENT CONTROL ORDINANCE (INCLUDING PROPOSED REGULATIONS)

December 6, 1982

Kenneth Baar & Dennis Keating

Prepared for:
The Berkeley Board of Adjustments

ALTERNATE FAIR RETURN STANDARDS
UNDER RENT CONTROLS

by

Kenneth Baar &
Dennis Keating

November 10, 1982

Prepared for the Berkeley Board of Adjustments for the purpose of providing technical assistance in the development of fair return standards under Measure I commercial rent controls.

ALTERNATE FAIR RETURN STANDARDS

UNDER RENT CONTROLS

INTRODUCTION

The issue of fair return standards under rent controls has always been a source of debate, headaches, and litigation. Although rent controls have been in effect for nearly a decade or more in approximately 100 New Jersey cities, several Massachusetts cities, Washington, D.C., and New York, there is still no judicial or legislative consensus on what fair return standards should be used. Every one of the types of fair return standards -- cash flow, return on equity (cash investment), return on value, percentage net operating income, and maintenance of net operating income -- has been struck down by some courts and upheld by other courts. While courts have been very restrained in reviewing zoning regulations and zoning board restrictions, they have not been hesitant to strike down rent controls, especially fair return standards. Trial courts have frequently struck down standards that do not comport with their notions of equity and fairness.

Therefore, there is a substantial possibility that no matter what fair return standard is adopted by the Board, it will be legally challenged. Almost every fair return standard that has been adopted under California rent controls has been challenged. Furthermore, there is a substantial posibility that any trial court decision in a challenge to a fair return challenge will be reversed on appeal. Trial court decisions on fair return standards in other states, where appellate court decisions on this issue have been made, have been commonly reversed.

As of this time, the California appellate courts have not ruled on what types of standards meet the constitutional fair return requirement under rent controls. In 1976, in Birkenfeld v. Berkeley,[1] the California Supreme Court stated that landlords were entitled to a "just and reasonable return on property," but did not define those terms.[2] The numerous California trial court decisions on the issue have not been completely clear and have been conflicting. Several are now on appeal.

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[1] 17 Cal. 3d. 129, 550 P.2d.1001, 130 Cal. R. 465.

[2] Id. 17 Cal. 3d. at 165, 130 Cal. R. at 491.

The fair return issue is rather complex and takes time to master. The experience of the New Jersey Supreme Court provides a good example of the complexity of the fair return issue. In 1975, the N.J. court ruled that owners were entitled to a fair return on the value of their property.[3] But, it held that since market values were determined by the housing shortage that led to the adoption of residential rent controls, an alternative measure of value should be used -- the hypothetical value of a property in a market free from the aberrant forces which led to the adoption of rent controls. Three years later, the same court decided that return on value standards were practically unworkable, in the context of rental housing price regulations.[4]

Each fair return standard has strengths and weaknesses. Furthermore, each rent control law, including the Elmwood Commerical rent control law, has its set of peculiarities in regard to fair return standards. In this memo, an attempt is made to explain each of the fair return standards as clearly as possible. Nevertheless, an ordinary reader may need to read the memo several times in order to accomplish complete "digestion" of the concepts and information set forth.

The Elmwood Ordinance

The ordinance contains two rent increase sections. Section 5(c) allows rent increases to cover increases in "maintenance and operating" expenses. In addition, it allows for rent increases to cover increased mortgage interest payments on existing loans. However, it does not allow for increases to cover increases in mortgage payments due to refinancing or new purchase financing.

Section 5 may be characterized as a "maintenance of dollar net operating income"[5] standard -- it maintains owner's base period dollar net operating income. Fair return standards of

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[3] Hutton Park Gardens v. Town Council of West Orange, 68 N.J. 543, 350 A.2d. 1; Brunetti v. Borough of New Milford, 68 N.J. 576, 350 A.2d. 19; Troy Hills Village v. Township Council of Parsippany-Troy Hills, 68 N.J. 604, 350 A.2d. 34 (1975). The three cases were decided on the same day.

[4] Helmsley v. Fort Lee, 78 N.J. 200, 394 A.2d. 65 (1978).

[5] Net operating income = gross rental income-operating expenses. Mortgage interest payments are not considered operating expenses.

this type are common in rent laws. Furthermore, "general adjustment" standards under rent controls are often designed to accomplish this purpose.

Section 6 states that:

> (a) If the application of this Ordinance, or any section or part thereof, would operate to violate the United States or California Constitution by denying a landlord a fair and reasonable return on investment or by confiscating the landlord's property, then such Ordinance, section, or part thereof shall apply to such landlord only to the extent that it does not deny him a fair and reasonable return on investment or confiscate his property...
>
> (c) The Board of Adjustments shall enact regulations relating to its duties under this Section, including the definition of "fair and reasonable return on investment."

Section 6(a) may be seen as acting as a "saving" clause, by stating that the other parts of the ordinance shall apply only to the extent that they do not violate the U.S. or California Constitution by "denying...a fair and reasonable return on investment or by confiscating the landlord's property." Section 6(c), by stating that the Board of Adjustment shall enact "regulations relating to its duties under Section 6, including the definition of 'fair and reasonable return on investment'", essentially enables the Board to take whatever steps it deems are necessary in order to meet the constitutional fair return requirements.

In regard to Section 6, a number of options exist. These include:

1. Adopt a return on investment fair return formula.
2. Adopt a cash flow standard.
3. Adopt a return on value standard.
4. Adopt a percentage net operating income standard.
5. Adopt a maintenance of net operating income standard with an inflation adjustment in the definition of fair net operating income.
6. Allow additional rent increases for units on which rents have had no rent increases or only minimal increases since a specified base date.
7. Not adopt a general formula. Instead review and consider each application based on its individual circumstances.

In the following section, each of these options is discussed and commented upon in detail.

Alternate Fair Return Standards

As an aid to discussion, Table I, below, describes each of fair return formula in the form of a mathematical equation designed to simplify comparison, and Table II compares the variables which each fair return standard takes into account.

Table I

Fair Return Standards

1. cash flow

   gross rent = operating expenses + mortgage payments

2. return on gross rent

   gross rent = x (operating expenses + mortgage payments)

3. return on equity

   gross rent = operating expenses + mortgage payments + x (cash investment)

4. return on value

   gross rent = operating expenses + x (value)

5. percentage net operating income

   gross rent = x (operating expenses)

6. maintenance of net operating income

   gross rent = base date gross rent + (current operating expenses - base date operating expenses)

Table II

Variables Considered in Fair Return Formulas

	Operating Expenses	Mortgage Interest	Value	Cash Investment	Base Date Gross Income	Base Date Operating Expenses
Cash Flow	X	X				
Return on Gross Rent	X	X				
Return on Equity	X	X		X		
Return on Value	X		X			
Percentage N.O.I.	X					
Maintenance of N.O.I.	X				X	X

1. Return on Investment Standard

Formula:

Rent required to yield fair return = x(cash inv.) + mortgage payments + operating exp.

The above formula and definition may be commonly used for calculating rate of return in a conventional real estate investment analysis, may be the first definition that comes to mind in regards to the term "fair return on investment", and may be in conformance with a literal reading if Measure I.

However, a standard of this type has not been commonly used under rent controls. Presently, it is used by only a small fraction of the 100 rent control boards in New Jersey.[6] In fact, a standard of this type has severe conceptual shortcomings in the context of price regulation and has been strongly criticized by some courts. Judicial consideration in regards to this type of standard has usually been about whether the standard is even rational enough to be constitutionally permissable, rather than over whether it is constitutionally required.

The conceptual failing of such a standard, as a regulatory standard, is clear. It leads to gross differences in permitted rents and rent increases in the common situation where cash investments and mortgage payments and rates of return vary greatly among owners due to differences in purchase price and purchase date. The following hypothetical illustrates these differences (the bottom line indicates the varying rents which would be defined as "fair return" for each owner):

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[6]However, two of the larger cities, Newark and Jersey City, are included in this group.

Table III

Fair Return in Cash Investment Formula

Applied to New, Moderate, and Long Term Owners

	New Owner	Moderate Term Owner	Long Term Owner
Purchase Price	300,000	200,000	100,000
Mortgage Debt	250,000	125,000	30,000
Cash Investment[a]	50,000	50,000	70,000
Annual			
Operating Expenses	5,000	5,000	5,000
Interest on Mortgage	32,500[b]	12,500[c]	2,100[d]
12% return on cash inv.	6,000	6,000	8,400
Rent which yields 12% return on cash investment	43,500	23,500	15,500

[a]Includes principal payments on mortgage.

[b]Assumes 13% interest rate.

[c]Assumes 10% interest rate.

[d]Assumes 7% interest rate.

In effect, under the formula, in the common situation where property values have been increasing over time, the purchase date becomes a chief determinant of what rent yields a fair return. As applied to an area of very rapid increases in property values over the past decade, such as Berkeley, the application of this type of formula may in some cases enable recent purchasers greater increases than long term owners, even if they are already charging substantially higher rents than the long term owners.

The return on investment standards, by assuring that rents will be adequate to cover mortgage payments and provide for a return on equity, serve as a self-fulfilling prophesy as to the reasonableness of an investment. If a return on investment standard was applied to future purchasers, it would in effect allow the regulated to regulate rents. Because investment is a business decision which is governed by expectations as to future income, it would be counter to the concept of regulation to use it as the measure of what income shall be permitted.

Precedent in other jurisdictions regarding return on investment standards has been somewhat confusing and conflicting and sometimes internally contradictory. However, it

clearly indicates that a return on investment standard of the type described above is not constitutionally required.

Discussion of return on investment standards by the New Jersey Supreme Court is somewhat contradictory. As previously indicated, only a small percentage of the New Jersey municipalities that have rent controls use a fair return on investment standard. In 1978, in Helmsley v. Fort Lee, the New Jersey Supreme Court stated in dicta, that "there are no obvious theoretical obstacles to using an investment-based standard."[7] However, in the same opinion it stated that a standard which results in differences in allowable rents due to differing mortgage rates "serves no legitimate governmental purpose."[8] In fact, discrimination of this type is inherent in return on investment standards, since they take mortgage interest payments into consideration. In any case, while the New Jersey court indicated that there were no obvious theoretical obstacles to using a fair return on investment standard, it also cited as acceptable both maintenance of net operating income standards and percentage net operating income standards,[9] both of which do not take mortgage payments and investment into consideration.

In 1976, in Zussman v. Rent Control Board of Brookline, the Massachusetts Supreme Judicial Court rejected the view that a rent board decision was confiscatory because it did not allow for rents which were adequate to cover mortgage interest payments and provide a return on cash investment.[10] Zussman had purchased a building after the adoption of rent control with the intent of converting its units into condominiums. The board valued the property considerably below the actual purchase price and allowed a rate of return on that value which was insufficient to cover mortgage payments. The trial court ruled that the board's decision was confiscatory "in light of the large interest factor with which (the plaintiff) is faced and which has in no degree been considered as a cost factor by the Board..."[11]

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[7] 394 A.2d. at 72,n.8.

[8] Id., 394 A.2d. at 80-81.

[9] Id., 394 A.2d. at 72-73.

[10] 359 N.E.2d. 29.

[11] Id., 359 N.E.2d. at 33.

The Supreme Judicial Court overruled the trial court, indicating that there were sound practical reasons why a rent board should not take a landlord's financing arrangements into account.

> Under c.842, a rent control board is not bound to consider the landlord's financing arrangements in setting rates, and there are sound practical reasons consistent with the intent of that chapter which support the board's policy. The rationale is particularly evident on the facts of this case, where the landlord has chosen to finance 100% of the cost of the building.
>
> The plaintiff's debt service charges clearly would be less if he had undertaken "conservative" financing, which the trial judge found to be 70% of fair market value. They would be even less had he chosen to give a more substantial down payment from his own funds. The plaintiff's use of 100% financing, whatever the motivation, was fundamentally a business decision within his discretion. Given the express concern of St.1970, c.842, Sec.1 with the "substantial and increasing shortage of rental housing accommodations for families of low and moderate income and abnormally high rents," a landlord's decision to minimize or wholly eliminate his initial capital outlay cannot justify imposing higher rents on his tenants. Nor does it warrant permitting him to collect higher rents than other less heavily financed landlords.[12]

The latter part of the above passage indicates that a policy of considering financing arrangements would be inconsistent with the purposes of the state rent control legislation.

The Massachusetts state enabling act requires that rents are set at levels which yield a "fair net operating income."[13] Pursuant to this directive, the boards have defined fair net

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[12] Id. 359. N.E. 2d at 33-34.

[13] Massachusetts Acts of 1970, c.842. Subsequently, this state enabling act has been replaced with enabling acts for individual cities which contain the same language.

operating income as base period net operating income.[14] (See pages 20-24 for discussion of this standard.)

The experience of California boards which have used fair return on investment standards is indicative of the complexities surrounding the fair return debate.

In 1979, Santa Monica adopted a rent control law which provided that: "In making individual and general adjustments of the rent ceiling, the Board shall consider...the landlords' rate of return on investment."[15]

Initially, the board adopted a fair return on investment standard which operated conceptually in the same manner as a maintenance or net operating income standard, by defining fair return on investment as base period return on investment. In appeals of individual rent adjustment petitions, trial courts repeatedly held that it was unconsistutional to lock owners into a negative cash flow. At that time, there was a high incidence of negative cash flow purchasers due to very rapid appreciation in values and expectations of exceptionally profitable condominium conversions. The board responded to the court decisions by adopting a return on investment standard which provided for a return on investment equal to the triple A bond rate. In order to cushion the impact of rent increases under the standard, the regulation provided that substantial rent increases would be phased in over a period of several years. Implementation of this standard led to substantial rent increases for recent purchasers, while providing no relief for long term owners.

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[14] In 1971 in Marshall House v. Rent Control Board of Brookline, 266 N.E.2d. 876, the Supreme Judicial Court of Massachusetts declared that the "fair net operating income" standard guaranteed owners a "reasonable return on their investment." Id., 266 N.E.2d. at 888. However, as indicated the Massachusetts boards have never adopted fair return regulations which take actual cash investment into account. The Massachusetts fair net operating income standard was taken from substantially identical language of the Federal Housing and Rent Act of 1949. Pursuant to that legislation, the housing expediter adopted regulations which specified as fair return, a net operating income equal to a designated percentage of gross rental income.

In effect, a fair return on investment has been guaranteed by maintaining former levels of net operating income.

[15] Santa Monica City Charter, Section 1805(e).

In March 1981, in a class action challenge to the constitutionality of the fair return on investment standard, after weeks of expert testimony, a trial court rules that the return on investment standard was unconstitutional.

Its statement of reasons as to why a return on investment standard is unconstitutional were compelling (and familiar).

> The 14th Amendment is infringed in denying equal protection of the laws. Under the rent control system as applied a landlord who purchases Whiteacre for $200,000 in 1977 will be allowed a much higher amount of rent than one who purchases Greenacre (a virtually similar piece of improved property) in 1970 for, say, $50,000. Someone who inherited Blueacre (a virtually similar piece of improved property) in 1973 may receive less permissable rents than either the owners of Whiteacre or Greenacre because there is little "investment" in Blueacre other than the amount of death duties paid as a result of inheritance. Such differentiation between owners of virtually identical properties is constitutionally impermissable.[16]

In response to that decision, the board adopted a maintenance of net operating income standard (partially indexed for inflation). After several more weeks of expert testimony that standard was upheld. Among the reasons why the new standard was upheld were the facts that it did not discriminate on the basis of purchase price and/or financing arrangements. Yet, the earlier trial court decisions in the individual challenges to board decisions had overturned board decisions due to their failure to consider the owner's financing expenses.

In addition to the conceptual problems associated with using a fair return on investment formula, practical problems exist. In cases where a property was inherited there is no investment. If a property was purchased many years ago, the initial investment may not be known. Also, owners may not have records of the investments in the form of capital improvements that they have made subsequent to the purchase of property. Under such a standard it would be necessary to determine how to treat reductions in investment subsequent to purchase through refinancing.

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[16] Baker v. Santa Monica, WEC 058763 (Superior Court of Los Angeles County, Memorandum of Intended Decision, p. 26, March 6, 1981).

If a return on investment is adopted, it would probably enable recent purchasers to obtain very substantial rent increases. Long term owners would not obtain rent increases even if they had not raised their rents in many years. Also, there would be a substantial likelihood (higher than for other types of standards) that the standard would be considered unconstitutional by both the trial courts and the appellate courts.

2. Cash Flow Standard

Formula:

Fair rent = mortgage payments + operating expenses

This formula assures that no owner has a negative cash flow.

In the early 1970's, a majority of New Jersey municipalities rent control ordinances contained this fair return standard (largely as a result of the fact that they copied verbatim the Ft. Lee ordinance which used this standard). At that time, the nature of the formula was not a serious issue, due to the fact that owners were not typically buying under negative cash flow circumstances and the municipal laws allowed for annual rent increases tied to the inflation rate, plus property tax passthroughs.

In the second half of the 1970's, cash flow standards and the question of whether owners have a constitutional right to rents which are adequate to cover operating expenses and mortgage payments took on increased importance as purchase price/rental income ratios soared and negative cash flows became common. In 1977, Washington, D.C. adopted a cash flow standard as an alternate ground for hardship rent increases.

Conceptually, the cash flow standard suffers from the same type of shortcomings as a return on investment standard. Under such a standard, purchase date becomes the chief determinant of what rent is fair. Furthermore, the standard discriminates between owners who have made substantial cash down payments and owners who have financed their purchases, because it fails to include consideration of cash investment in its formula. The following hypothetical illustrates how two owners who paid the same price may fare far differently under a cash flow standard.

	Owner A	Owner B
Purchase Price	200,000	200,000
Downpayment	40,000	100,000
Mortgage	160,000	100,000
Annual Mortgage payments	16,000	10,000
Annual Operating Expenses	5,000	5,000
Annual Minimum Fair Rent	21,000	15,000

The strength of the standard is that it meets a gut reaction that no owner should be forced to operate at a loss. In fact, such a formula (like fair return on investment formulas) works in a somewhat circular manner, because the purchaser's expectation regarding rents, as expressed in the form of mortgage payments, becomes the determinant of what rents may be charged. Under the formula, if an owner obtained a $1 million mortgage, that owner would be entitled to rents adequate to cover that mortgage. Conversely, if the owner did not obtain a mortgage, then that owner would only be entitled to rents adequate to cover operating expenses.

In some jurisdictions, including Los Angeles, trial court judges have taken the position that it is unconstitutional to lock an owner into a negative cash flow. However, appellate courts in other states have consistently rejected the view that an owner has a constitutional right to charge rents which are adequate to cover mortgage payments and operating expenses. In 1975, the New Jersey Supreme Court explained that:

> Rent levels may permissably work hardships on landlords in atypical cases, may drive inefficient operators out of the market, and may preclude persons who have paid inflated purchase prices from recovering a fair return.[17]

As indicated in the discussion of return on investment standards, the Massachusetts Supreme Judicial Court has also rejected the view that a rent control is confiscatory because it locks an owner into a negative cash flow.

Nevertheless, a local trial court may decide not to be persuaded by these precedents, especially since the Massachusetts case involved a post-rent control purchaser. On the other hand,

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[17] Troy Hills Village v. Township Council of Parsippany-Troy Hills, 350 A.2d. 34,47.

the California courts may find a cash flow standard unconstitutional for the same reasons expressed by courts in other states and the reasoning set forth by the trial court in the Santa Monica case -- such a standard irrationally discriminates on the basis of purchasing financing arrangements.

3. Return on Value

Formula:

Gross rent = operating expenses + x(value)

When a return on value standard is used, an owner is entitled to rents which are adequate to cover operating expenses and yield a specified rate of return on value. Mortgage interest payments are not considered as an expense, since the rate of return is calculated on the full value of the property rather than the owner's equity. Since the standard is value based, rather than investment based, it does not discriminate on the basis of purchase price or financing arrangements.

Return on value standards have been used in residential rent controls in New York City, Washington, D.C. and some New Jersey municipalities. Under New York City's commercial rent control, a return on value standard was also used (New York City commercial rent control is discussed in the accompanying memorandum). Usually, value has been defined as assessed value (or equalized assessed value) and rates of return ranging from 8% to 12% have been designated as fair.

In the 1920's, courts consistently held that landlords are constitutionally entitled to a fair return on the "value" of their property.[18] However, since that time, New Jersey, Massachusetts, and federal courts have concluded that the use of fair return on value standards is conceptually unsound in a rent controlled context and have rejected the view that landlords are constitutionally entitled to a fair return on the value of their property.

A serious conceptual failing of this standard is its circularity. The use of a return on value standard in a rent controlled context is "circular" because the value of a rental property is largely determined by its projected income stream.

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[18]Federal and state courts applied the reasoning set forth by a New York City trial court in Hirsch v. Weiner, 190 N.Y.S. 111 (1921). See e.g. Karrick v. Cantrill, 277 F. Supp 578) and Stephens v. American Real Estate Co., 279 F. Supp. 435 (1921).

Therefore, when rent controls govern what rents may be charged, they determine the value of a property. The reward of a rent increase pursuant to a return on value standard leads to an increase in value which may in turn justify another increase.

In 1978, in Helmsley v. Fort Lee,[19] the New Jersey Supreme Court explained:

> The preferred valuation method for apartment buildings is capitalization of income, since investors purchase apartment buildings as income producing property ... Once income is controlled, however, using capitalization of income to determine value to regulate future income is a circular process. [20]

Massachusetts courts have reached a similar conclusion.[21]

Furthermore, the use of market value in a fair return formula can also pose severe practical problems. Conclusions about fair market value, whether they are made by an appraiser, an assessor, or a rent control board, are highly subjective. They involve comparisons between a property and "comparable" properties which have recently sold, evaluation of the physical condition of a property, and adjustments for locational factors. The use of market value standards can turn fair return hearings into expensive battles of experts arguing over value.

In other states, when return on value standards have been used, the administrative problems associated with the problem of determining value have been usually overcome by defining value as assessed value.

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[19] 394 A.2d. 65.

[20] Id. 394 A.2d. at 71.

[21] In Niles v. Boston Rent Control Administrator, 374, N.E.2d 296, the Massachusetts Court of Appeals commented:

> Where rents are based on the fair market value of the property which in turn is determined by the rents received on the property, the process is circular. Moreover, whether fair market value is based on rents or on comparable sales, use of this figure as a basis for setting rents can result in incorporating inflationary factors into the rental formula.
>
> Id. at 301.

Due to Proposition 13, which since 1978 has limited increases in assessed value to 2% per year above 1975 values, except in the instance where a property is sold, the use of assessed value as a measure of value is not a viable option in California. This results from the fact that assessments do not reflect market values, except where properties have been recently sold.

Alternate Approaches to Value -- The "Historic" Value Approach

In some instances, other measures of value have been suggested in order to overcome the "circularity" problem. It has been argued that the use of "historic" value, such as value just prior to the adoption of rent control, would overcome the circularity problem. A "historic" value standard overcomes the spiralling effect in which one rent increase leads to a higher value, which in turn justifies another rent increase. It also avoids incorporating the effects of rent control on value into the regulatory scheme.

Nevertheless, the historic value standard still suffers from circularity problems because pre-rent control expectations about future rental income stream and appreciation are major components of pre-rent control values. In particularly tight rental markets, pre-rent control values are particularly high. Therefore, the use of pre-rent control values in a fair return standard incorporates expectations derived from the "imbalanced market" which led to the imposition of rent controls.

In 1942, in Wilson v. Brown, the Emergency Court of Appeals commented:

> The use of market value as a test is inconsistent with the regulation of rents, because the value of the property on the market depends in large measure upon its earnings and inflated rents result in inflated market values.[22]

In 1972, the Supreme Judicial Court of Massachusetts approved the findings and rulings contained in a district court opinion which invalidated a Cambridge return on value standard.[23] The district court explained that the use of a

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[22] 137 F.2d. 348, 353.

[23] Rent Control Board of Cambridge v. Gifford, 285, N.E.2d. 449 (1972).

return on a value standard is not valid under rent control because it incorporates into the rate making scheme the shortage factors which led to the adoption of rent controls. The district court explained that:

> If the fair return is to be based on market value, other elements than the landlord's investment are involved, such as the increased value which has arisen because of a substantial and increasing shortage of rental housing accommodations which result in the landlord receiving more than a fair return on his investment. It results in his getting the benefit of the emergency conditions which [the rent control act] gives as the reason for enactment of the act.[24]

While the view that rent controlled owners are entitled to a fair return on the value of their property has been rejected by appellate courts in Massachusetts and New Jersey, the question still has not been resolved in California.

As previously indicated, in 1976, in Birkenfeld v. Berkeley, in the process of striking down the 1972 Berkeley rent control ordinance, the state supreme court commented:

> The provisions [of a rent control law] are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time provide landlords with a just and reasonable return on their property.[25]

However, it did not define these terms. It has been argued that the language "just and reasonable return on their property" requires that a return on value standard be used.

However, there are compelling arguments that counter this view. In the Birkenfeld case, the 1972 Berkeley law was struck down because it virtually precluded owners from getting any rent increases for years. Under the ordinance, the board was precluded from making any general adjustments. Instead, rent petitions for each of the 17,000 rental units in Berkeley had to be individually processed and heard by the full board.

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[24] Ackerman v. Corkery, Third District Court of E. Middlesex, Eq.17 (1971) as cited in Niles v. Boston Rent Control Administration, 374 N.E.2d. 296, 302, n.10.

[25] Supra note 2.

(Decision-making could not be delegated to a hearing examiner and petitions could not be consolidated for a building without the consent of the tenants). As a result, the nature of the fair return standard in the ordinance was not at issue and the above-cited comments should not be seen as indicative of any particular view about fair return standards.

The history of fair return court decisions in Massachusetts and New Jersey illustrates why the comment by the California Supreme Court about "return on...property" will probably not be interpreted to mean return on value.

In 1969, the Massachusetts state legislature requested the State Supreme Judicial Court to issue an "advisory opinion" on the constitutionality of a proposed municipal rent control enabling act. In an "Answer of the Justices," the court commented that: "The bill sets forth no standards for ensuring a fair return on the value of the property..."[26] The state enabling act adopted subsequent to the "Answer of the Justices" provided that adjustments would be made as necessary "to assure that rents for controlled rental units are established at levels which yield landlords a fair net operating income." Pursuant to the act, localities adopted rent controls which included maintenance of net operating income fair return standards. When, in challenges to the fair return standards, it was argued that a fair return on value was required, the Massachusetts courts consistently rejected this view, notwithstanding plaintiff's reliance on the above-cited language from the "Answer of the Justices."[27]

In 1975, the New Jersey Supreme Court attempted to devise a definition of value, other than fair market value, which would be appropriate in a rent regulation context. The court discussed at length why market value would not be appropriate for use in measuring fair return, using reasoning similar to that advanced in Wilson v. Brown and the Massachusetts courts. Then, as previously indicated, it concluded that a fair return on the value "in the context of a hypothetical market in which the supply of available rental housing is just adequate to meet [demand]"[28] was the constitutional standard. It also described fair "rate of return" in a rather abstract manner.

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[26] Answer of the Justices to the House of Representatives, 250 N.E.2d. 450 (1969).

[27] See e.g. Wiles, supra note 24 and cases cited therein.

[28] Supra note 350 A.2d. at 44.

> A rate of return must be high enough to encourage good management including adequate maintenance of services, to furnish a reward for efficiency, to discourage the flight of capital from the rental housing market, and to enable operators to maintain and support their credit. A just and reasonable return is one which is generally commensurate with returns on investments in other enterprises having corresponding risks.[29]

Three years later, the same court concluded:

> The theoretical problems of valuation were here compounded by the practical difficulties of estimating value in a hypothetical housing market where supply and demand are in equilibrium... In Troy Hills Village, supra, we outlined tentative guidelines for determining whether a rent control ordinance was confiscatory. At the same time, we cautioned that further litigation would be needed to illuminate this complex subject. After considering the massive record compiled by plaintiffs, we are satisfied that a value-based criterion for confiscation under rent control is practically unworkable.[30]

These passages help illustrate the initial attractiveness of a return on value concept and the practical difficulties associated with trying to develop precise return on value guidelines.

In California, a number of trial courts have considered the return on value issues. In the most noted case, Baker v. Santa Monica, the trial court held that the "just and reasonable return on property" language meant a fair return "current fair market value" of property.[31] However, the court then upheld a net operating income standard that does not contain "value" as a variable. The court concluded that the net operating income standard, which allowed for a growth in net operating income at 40% of the inflation, allowed a fair return on the value of property.[32] But, the court indicated that if, in an individual case, an owner could not get a fair return under the net operating income standard, the remedy of judicial mandamus could still be sought.

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[29] 350 A.2d. at 43.

[30] Helmsley v. Fort Lee, 394 A.2d. 65, 72.

[31] Supra note 16, Memorandum of Intended Decision, p. 29, (March 6, 1981).

[32] Id., Announcement of Intended Decision - Phase II, (February 19, 1982).

In Fisher v. Berkeley, the view that the current residential rent control ordinance is unconstitutional because it does not provide for a fair return on value was rejected by the trial court.[33] In Munger v. Berkeley, Judge Bostick would not rule on whether a return on value standard was required in considering motions for summary judgment, instead leaving the question for trial.[34] Since then, Bostick has retired.

In 1980, a trial court judge ruled, relying on Birkenfeld, that the Cotati fair return on investment standard is unconstitutional and that owners are entitled to a fair return on the value of their property.[35] Presently, the case is on appeal.

4. Percentage Net Operating Income

Formula:

Gross rent = x (operating expenses)

(Alternative expression of formula:

Net operating income = x% of gross rents)

Under the percentage net operating income standard, owners are entitled to a rent increase if their net operating income is less than a designated percentage of gross rental income. The underlying theory of the standard is that landlords should be guaranteed a minimum net operating income/gross rent ratio in order to provide adequate income for debt service and profit.

A percentage net operating income standard was in effect under federal rent controls from 1949 to 1953,[36] and, within the past few years, has been adopted by about ten New Jersey municipalities.

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[33] No. 536602-6 (Alameda County Superior Court). Now on appeal. 1 Civ. 52332.

[34] No. 541003-9 (Alameda County Superior Court).

[35] Cotati Alliance for Better Housing v. City of Cotati, No. 108247 (Superior Court, Sonoma County, Order Granting Plaintiffs' Motion for Judgment on the Pleadings, December 23, 1980).

[36] 24 C.F.R. 825.5 (18); 14 F.R. 2233 (May 5, 1949).

Usually, under residential rent controls, a net operating income equal to 35% to 50% of gross rental income, has been designated as a fair return.[37] The fair net operating income percentages that have been chosen are usually in the range of average net operating income ratios for a jurisdiction.

The chief strengths of the standard are: (1) it avoids the circularity associated with return on value standards, and (2) it is not hostage to the owner's particular purchase price, investment, or financing arrangements.

The chief problem with the standard is that it pegs fair return at a particular net operating income/gross rental income ratio, despite the fact that in reality operating expense/gross rent ratios vary widely among buildings. In a residential rent control context, development of fair percentage net operating ratios has been feasible due to the fact that a substantial portion of maintenance and operating expenses are generally paid for by owners and consume a substantial portion of rental income. In the commercial context, due to the fact that a substantial portion of maintenance and operating expenses are assumed by tenants, it would be impossible to develop meaningful ratios that would yield "fair" rents. (Furthermore, due to the operation of Proposition 13, property tax/rental income ratios vary greatly between properties based on differences in purchase date, therefore further rendering the net operating income/rental income ratio concept inappropriate for price regulation purposes).

5. Maintenance of Net Operating Income (Cost Passthrough Approach)

Formula:

Gross rent = base period rent + (current oper. exp. - base period oper. exp.)

Under maintenance of net operating income standards, owners have a right to rent increases which are adequate to cover increases in operating expenses. (Thus the base period net operating income (n.o.i.) of a property is maintained and "fair net operating income" is defined as the net operating income that a property yields during a base period. In the event that a fair return standard of this type is adopted, base period will have to be defined for the purposes of the regulation.[38] As previously indicated, Section 5 of Measure I contains a standard of this type.

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[37]Under federal rent controls, lower percentages were defined as fair, but depreciation was allowed as an expense.

[38]Discussion of base period definitions is reserved, pending discussion of this memo by the Board.

Maintenance of net operating income standards were used under federal rent controls and are presently used by New York City, the three Massachusetts rent control boards, approximately five New Jersey cities, Berkeley (residential rent controls), Santa Monica, and Los Angeles. Under the federal, Massachusetts, and California rent controls, a pre-rent control base period has been used, based on the presumption that a pre-rent control net operating income is no less than fair, because it was based on rents set in an unregulated market.[39]

The maintenance of net operating income standard recognizes that in the unregulated rental housing market landlords earn varying rates of return. Therefore, rather than designating a particular rate of return as fair, it preserves prior n.o.i. levels.

The principal debate associated with the use of maintenance of net operating income standards has been over what, if any, types of adjustments should be made for inflation in defining fair net operating income. Some maintenance of net operating income standards provide for maintenance of base period dollar net operating income without any adjustment for inflation since the base period. Other jurisdictions have adopted maintenance of net operating income/gross income ratio standards or have provided for full inflation adjustments to the base period net operating income in defining fair net operating income. The difference between maintaining dollar n.o.i. and adjusting n.o.i. for inflation and maintaining an n.o.i. gross rent ratio is significant, as indicated by the example below.

Table IV

Alternate Maintenance of Net Operating Income Standards

	Base Year	Current Year		
		Maintain Dollar n.o.i.	Maintain n.o.i. Adjusted for 33% Inflation	Maintain n.o.i./ gross ratio
Expenses[a]	2,000	3,000	3,000	3,000
Net Operating Income	8,000	8,000	10,640	12,000
Gross Rental Income	10,000	11.000	13,640	15,000

[a]In this hypothetical, expenses equal 20% of rental income. Preliminary data received by the Board of Adjustments indicates that Elmwood commercial tenants pay for most expenses.

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[39]The use of pre-rent control base date has not been feasible under New York City and New Jersey rent controls due to the fact that they were adopted long after the adoption of rent controls, thereby making it unreasonable to require landlords to produce pre-rent control income and expense data.

In the above hypothetical instance when operating expenses increase by $1,000 and there has been 33% inflation since base period, a $1,000 rent increase is necessary to maintain base period dollar net operating income, while a $3,460 increase is necessary to maintain n.o.i. indexed for inflation of 33%, and a $5,000 increase is required to maintain the base period n.o.i.

An intermediate choice is to index base date net operating income by a fraction of the inflation rate. If n.o.i. were allowed to increase at only 50% of the inflation rate, owners who devoted more than 50% of their n.o.i. to fixed debt service payments would realize a growth in cash flow in excess of the inflation rate. The following hypothetical example, which assumes that 50% of net operating income is devoted to fixed payment mortgage debt service and that there has been 33% inflation between the base period and the current year, illustrates the impact of increasing n.o.i. at 50% of the inflation rate.

	Base Year	Current Year	% Increase Over Base Year
Gross rental income	$10,000	$12,280	22%
- Operating expenses	2,000	3,000	50%
Net operating income	8,000	9,280	16%
- Debt service	4,000	4,000	0%
Cash Flow	$ 4,000	$ 5,280	32%

In the above example, cash flow has increased by 32%, although net operating income has increased by only 16%. For more highly "leveraged" owners, a small growth in net operating income will lead to a substantial percentage growth in cash flow, while for less highly leveraged owners (e.g., long term owners) percentage growth in cash flow will more closely parallel percentage growth in net operating income.

Up to the present, jurisdictions which have used the maintenance of net operating income standard have either made no adjustment for inflation or have provided for a 100% adjustment. (New York City has alternated between 0 and 100% adjustments.

Santa Monica and Brookline are the only exceptions to this pattern. In 1981, Santa Monica adopted a fair return standard under which n.o.i. is permitted to increase at 40% of the inflation rate. The Brookline, Massachusetts rent control board permits n.o.i. to grow at 50% of the inflation rate.

While no standard is above conceptual and practical criticisms, maintenance of net operating income standards have the following advantages over other types of standards:

1. They do not discriminate on the basis of purchase price or cash investment.

2. They do not discriminate on the basis of financing arrangements.

3. The provide an incentive for increased maintenance by providing for a passthrough of all operating cost increases. In contrast, other fair return standards do not provide for a passthrough of operating cost increases in instances where the owner is making more than a "fair" return on the base date, since such owners may experience a reduction in net operating income and still be earning more than a "fair" return.

4. When an inflation adjustment (partial or total) is applied to the base period net operating income in calculating a fair net operating income, a steady growth in net operating income is assured. In contrast, under other standards, owners may suffer a reduction in net operating income and still be earning a "fair" return.

5. Maintenance of net operating income standards are objective and the analysis required to administer them is relatively simple to perform. Base period net operating income needs to be calculated and compared with current net operating income. It is not necessary to determine the value of the property or the owner's cash investment. (Subjective evaluations of the reasonability of operating expenses are required; however, operating expenses are a variable which must be evaluated under all fair return formulas.)

The other significant advantage of maintenance of net operating income standards is that they have never been struck down by appellate courts, including the Massachusetts courts, even though they have been in effect in Massachusetts for nearly a decade. As previously indicated, in Helmsley v. Fort Lee, the New Jersey Supreme Court noted them as an acceptable type of standard.[40]

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[40] 394 A.2d. at 73.

Furthermore, the maintenance of net operating income approach deals with the concern of the New Jersey court that led it to strike down a Fort Lee ordinance -- the fact that its rent controls were certain to lead to a steady reduction in owners' net operating income.

As previously indicated, a trial court upheld the Santa Monica maintenance of net operating income standard, after striking down its return on investment standard and staying its decision in order to give the board an opportunity to formulate a new standard. However, the court hedged its decision somewhat by stating that: "This court is ruling as to the generality of the constitutionality of [the regulations] and not as to its effect upon every landlord."[41]

6. Adjusting the Base Rent

One criticism that has been raised about maintenance of net operating income standards and rent controls in general is that they discriminate against owners who have not raised their rents in many years. In the case of commercial rentals, substantial variations in rents for comparable space and disparate patterns of rent increases may be very common and even more pronounced than among residential rentals, since commercial leases are usually much longer than residential leases and turnover in tenancy is far less frequent.

Some rent control laws have addressed this issue by providing for additional percentage increases for units where rents have not been raised. For example, under New York City's commercial rent control law, landlords were allowed 15% increases if they had not increased rents during specified periods. (See memo on commercial rent controls.) When Los Angeles adopted rent controls in 1979, it permitted 13% rent increases for units which had not experienced increases since May, 1977, and it permitted 19% increases for units which had not had increases since May, 1976.[42]

In most instances, the extra increase provisions for units which have not experienced recent rent increases have been relatively short term (a few years). This is due to the fact that authorization of substantial rent increases (for example, equal to 5 years of general adjustments under a residential rent control law) would be counter to the rent control purpose of providing tenant security. Also, in the case of city-wide

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[41] Supra note 16 at p.16.

[42] L.A.M.C. 151.06 (1979).

residential rent controls, the problems associated with documentation of rent levels at an earlier date are serious. In contrast, the documentation problems under the Elmwood rent controls are far less serious. Many of the tenants are long term and only 80 rental units are involved.

Drafting Clauses Which Adjust Base Period Rents for Fair Return Purposes

Experience under rent controls with clauses which provide for additional rent increases for units which have experienced no rent increases or very minimal increases is very limited. Any clause of this type should be carefully thought out and tested under a number of hypothetical situations in order to avoid unintended results.

At this time, it is our thought that such a provision should designate as a fair base rent a designated percentage of the rent in effect on an earlier date. For example, fair base rent equals not less than the rent as of the year 19__, adjusted upwards x%. The standard should not state the clause only applies if there have been no rent increases since the earlier designated period, because then it would exclude a unit which might have experienced a one percent rent increase. Instead, in such a case the allowed increase should be the difference between the amount allowed for a unit which experienced no rent increase and the amount of increase for that unit. For example, if a 15% increase were allowed for a unit which had no rent increase since a certain date, then a 10% increase should be allowed for a unit which has experienced a 5% rent increase.

Phasing-In Increases

In order to cushion the shock of substantial individual fair return adjustments, many rent laws have placed a ceiling on the percentage annual rent increase allowed pursuant to such adjustments and have required that larger increases be phased in over a period of years. 15% has been the most typical ceiling. Despite the fact that these ceilings are widespread, they have not been challenged and reviewed by an appellate court.[43]

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[43]One trial court decision in New Jersey, striking the 15% ceiling, is now on appeal.

7. Individualized Review of Landlord Appeals Without a Fair Return Formula

The Board could decide not to adopt a fair return formula or formulas. Instead, it could review each landlord application individually, taking into account the specialized circumstances surrounding each application.

This approach has three major drawbacks. First, the Board may face the difficult prospect of reviewing applications from most of Elmwood's regulated commercial landlords. Second, however many appeals the Board hears, it may find it difficult to determine what constitutes a fair return without having at least general guidelines, if not a formula. Third, rent control ordinances in California and New Jersey have been challenged because the law had no fair return formula and the boards administering these ordinances failed to adopt one. The New Jersey Supreme Court has ruled that a landlord is entitled to know what fair return formula will be applied to their application.

FAIR RETURN UNDER NEW YORK CITY'S EMERGENCY COMMERCIAL AND BUSINESS SPACE RENT CONTROL LAWS 1945-1963

by

Dennis Keating

November 10, 1982

Prepared for the Berkeley Board of Adjustments for the purpose of providing technical assistance in the development of fair return standards under Measure I commercial rent controls.

INTRODUCTION

In 1945, New York City became the first American city to adopt non-residential rent control. In response to the World War II emergency, the New York State legislature conducted extensive hearings on the shortage of commercial and business space in New York City, concluded that an emergency existed, and then enacted rent control legislation. The initial law was applicable to commercial space (any commercial space except for stores and offices) and the second law was applicable to business space (stores and offices).[1] This temporary emergency legislation was extended until 1963, when it was allowed to expire. Within the past two years, the revival of commercial rent control in New York City has been proposed but has not yet been adopted.

While New York City's law differs from Measure I, judicial scrutiny of its often-litigated fair return formula over its 18-year life offers considerable guidance for the Board's consideration.

STRUCTURE

Emergency Basis

Similar to Measure I, these New York City commercial rent control laws were legally based on New York City's right to invoke its police power to deal with a public emergency:

> Unjust, unreasonable, and oppressive leases and agreements for the payment of rent for commercial space in certain cities having been and being now exacted by landlords from tenants under stress of prevailing conditions accelerated by war, whereby a breakdown has taken place in normal processes of bargaining and freedom of contract has become an illusory concept, and whereby there have come into existence conditions threatening to obstruct the production and distribution of essential civilian commodities, and to cause inflation, and all of the foregoing situations and conditions being a threat to essential civilian activities, and to the public safety, health, and general welfare of

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[1] McKinney's Unconsolidated Laws, Sections 8521-8538 and Sections 8551-8567. See generally Louis M. Meringolo, "Rent Control: What Remains and Its Future," 22 Brooklyn L. Rev. 207 (1958).

> the people of the state of New York, it is hereby declared that a public emergency exists without promise of relief so long as conditions brought about by war continue, and that action by the legislature is imperative and will not permit of delay. It is hereby found by the legislature that for the duration of such emergency, the establishment of a maximum rent for commercial space...will curb the evils arising from such emergency and will accomplish the purposes hereby sought to be achieved.[2]

Commercial landlords challenged the continuance of this wartime emergency. In Lincoln Building Associates v. Barr,[3] landlords argued that by 1955 (when these laws were re-enacted) the wartime shortage had ended and claimed that continuation of commercial rent control violated their constitutionally-protected rights to due process, equal protection, and contract. However, the Court of Appeals held that the Legislature had a rational basis for re-enactment in the absence of any convincing evidence to the contrary. However, the Court declared that only an emergency could justify temporary rent control and noted:

> Whether and for how long the Legislature may lawfully continue office rent control must, and shall, be a question open for future review.[4]

The California Supreme Court has since ruled that California cities can enact rent control on the basis of serious problems, such as those cited in Section 2 in Measure I, even without the existence of an emergency.[5]

New York City gradually phased out commercial rent control by allowing landlords to evict tenants if they were unable or unwilling to "match" the market rent terms of "comparable" tenants for two-year leases. While this exception originally

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[2]Id. at Sections 8521 and 8551.

[3]1 N.Y.2d. 413, 135 N.E.2d. 801 (1956). The landlords evidence consisted of vacancy data.

[4]Id. at 806.

[5]Birkenfeld v. City of Berkeley, 130 Cal. Reporter, 465 (1976).

applied only to office leases involving annual rents of $20,000 or more, by 1960 this was reduced to only $2,500. This made gradual decontrol inevitable.

Nevertheless, a landlord again challenged the constitutionality of the laws in Lincoln Building Associates v. Jame.[6] The Court of Appeals, in 1960, again upheld the law, reiterating that the Legislature had a rational basis for its continuation. However, the Court stressed that it also recognized a gradual decontrol program was then in effect.

The New York State Legislature then allowed commercial rent control in New York City to expire at the end of 1963.

Measure I has no such decontrol or termination provisions.

Coverage

Unlike Measure I, the New York laws exempted certain businesses.[7]

Base Rents

The base rents were the rents in effect on March 1, 1943 (for commercial space) and June 1, 1944 (for business space). Commercial landlords were, however, allowed to increase their base rent by 15% and this rent was presumed to be fair.[8]

Rent Increases

Landlords were allowed to increase rents above the base rent either by arbitration with the landlord or by petition to the Supreme Court (New York's trial court). Unlike Measure I, no administrative agency reviewed landlord appeals. The statute provided guidelines for adjusting rents:

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[6] 203 N.Y.S.2d. 86, 168 N.E.2d. 528 (1960). See Note, 7 N.Y.L.F. 81 (1961).

[7] McKinney's Unconsolidated Laws, Section 8533.

[8] Id. Sections 8521, 8523, 8551, and 8553.

> In the determination of the amount of such reasonable rent: (a) due consideration shall be given to the cost of maintenance and operation of the entire property (including land and building or other rental area in which such commercial space is located) including amounts paid for taxes assessed against such property, and to the kind, quality and quantity of services furnished, but excluding amortization or interest paid or accrued on any incumbrances thereon; (b) such rent shall be fixed in such a manner that it shall not exceed a fair and reasonable proportion of the gross rentals from all the commercial space in the entire building or other rental area, giving due consideration to the amount and character of the commercial space used or occupied by such tenant, provided, however, that the gross rentals from all such commercial space shall not exceed a fair and reasonable proportion of the gross rentals from the entire building or other rental area.[9]

These laws did allow for the continuation of existing leases which had been signed prior to June 1, 1939 on the basis of a "comparable" rent.[10] Leases with graduated payments which predated the creation of these laws were also allowed to continue in force until their expiration based upon the fixing of a comparable rent.[11]

Like Measure I, no waiver of the allowable rent ceilings was permitted.[12]

Fair Return

New York's laws included a fair return on value standard. A fair return was "presumed" to be a net annual return of 8% on the fair value of the entire property. The current assessed value was presumed to be the fair value, but other evidence concerning value was allowed. The landlord was allowed a return

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[9] Id. Sections 8524 and 8554.

[10] Id. Section 8522(e) and 8552(c).

[11] See Harvey Holding Corporation v. Satter, 75 N.E.2d. 619 (1947).

[12] McKinney's Unconsolidated Laws, Sections 8532 and 8562.

of 6% on the value of the land and building and an additional 2% for amortization of any outstanding mortgages.[13] The statute provided that the courts could consider:

> ...the cost of maintenance and operation of the building or other rental area during the preceding year, the kind, quality and quantity of services furnished during such year; and such other facts as the landlord claims affect the net income of the entire building or other rental area, or the reasonableness of the rent to be charged.[14]

Once the fair return was determined:

> ...the court shall then determine the fair rental value per square foot of the rentable commercial space in such building or other rental area, taking into account the character and location of such space, by dividing the amount of the total net rentable space into the total of the basic return found as aforesaid. At any stage of the proceeding the tenant and the landlord may enter into a written stipulation that the fair rental value per square foot of the commercial space occupied by the tenant is the amount stated in such stipulation and consenting that the court so determine, and the court, upon such stipulation, may make its determination of such fair rental value in the amount so stated. Thereafter the landlord shall be entitled to receive rent, dating from the time the application was made, at the rate per square foot so determined and the court shall fix at such rate the rent of any tenant occupying commercial space in such building or other rental area and who is paying rent at a rate per square foot less than the fair rental value so fixed.[15]

These laws limited annual rent increases based upon the fair return requirement to 15%.[16]

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[13] Id. Sections 8524 and 8554.

[14] Id. Sections 8524(1) and 8553(1).

[15] Id. Sections 8524(2) and 8553(2).

[16] Id. See Brunswick Site Co. v. Fishman Co., 118 N.Y.2d. 819 (1953) (upholding the 15% annual ceiling).

Evictions

Like Measure I, these laws allowed commercial landlords to evict tenants for cause. Fourteen (14) grounds were allowed as a basis for eviction.[17]

CONSTITUTIONALITY OF THE FAIR RETURN ON VALUE FORMULA

The constitutionality of the fair return on value formula was challenged by landlords. In 1945, the New York Court of Appeals upheld the constitutionality of commercial rent control in Twentieth Century Associates v. Waldman.[18] It simply noted that every commercial landlord was entitled to a judicial determination of a "reasonable" rent.

In subsequent decisions, the New York courts rejected further landlord challenges to the constitutionality of these statutes, the fair return formula, and its application. In this period, the courts reviewed several important aspects of this fair return formula.

Non-Mortgaged Buildings

In Hecht Broadway v. Ashenfarb,[19] the Court of Appeals rejected the argument that the fair return formula unconstitutionally discriminated in favor of owners with mortgages since they were entitled to an 8% return, while non-mortgaged properties were only entitled to a 6% rate of return.

Presumption of Fair Return

In In re Fifth Madison Corporation, the Court of Appeals upheld the fair return formula as presumptively reasonable.[20] This meant that landlords had the burden of proof to show that the application of this standard was unreasonable.

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[17] Id. Sections 8528 and 8558.

[18] 63 N.E.2d. 177, cert. denied, U.S. (1945).

[19] 298 N.Y. 769, 83 N.E.2d. 464 (1948).

[20] 297 N.Y. 155, 77 N.E.2d. 134 (1948).

In Steinberg v. Forest Hills Golf Range,[21] the Court of Appeals ruled that landlords were not automatically entitled to the statutory rate of return because the law only created a "presumption" that this was a fair return:

> The legislature...has declared its findings as to the return to which a landlord is normally entitled. But that statute, merely creating a presumption, is not a mandate to employ an 8% factor in every case. Obviously, the owner of an unimproved parcel of land found to be valuable because of its availability for development cannot expect to receive the same rate of return upon its value as he would if it were appropriately improved.[22]

In this case, the landlord bought unimproved property. The interest on the mortgage was double the rent. The Court upheld a return of only 3½%:

> If the amount of interest payable on a mortgage were permitted to determine the reasonableness of the return, a property mortgaged up to its full value, reducing to zero the investment by the owner, would produce the highest rent -- a manifestly absurd result.
>
> The emergency rent laws were enacted to control rent, to protect tenants and to assure to landlords a return that was -- having in mind the type and character of the property and all other relevant circumstances -- reasonable, and not to guarantee to investors in real estate a net annual return or to indemnify any particular landlord against loss on his investment or speculation. The emergency rent legislation was never designed to give a landlord a higher return under rent control than he could have obtained in its absence and in a free market.[23]

New York's return on value formula did not take the landlord's cash investment or debt service into account.

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[21] 303 N.Y. 577, 105 N.E.2d. 93 (1952).

[22] Id. at 96.

[23] Id. at 97.

Landlords were held to be entitled to less than the statutory presumptive fair return figure in subsequent cases.[24] On the other hand, a landlord was not necessarily entitled to a return higher than the statutory standard.[25]

Calculation of Income and Expenses

The commercial landlord was entitled to a fair return in addition to operating and maintenance costs.[26]

Landlords were required to file a bill of particulars "to establish their income and operating and maintenance expenses. These figures were then subject to tenant challenge and judicial review.[27]

In numerous cases the courts readjusted income and expense data in determining what constituted "net annual return." The courts determined both whether claimed expenses were correctly calculated and whether they were "reasonable."[28]

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[24]See e.g. In re Rego Park Houses, 113 N.Y.S.2d. 174 (1951) (4% return on condemned property).

[25]In Application of Cora Realty Corp., 122 N.Y.S.2d. 72 (1953), an increase was denied because the landlord's net annual return exceeded the statutory standard.

[26]See Application of 551 Fifth Avenue, 97 N.Y.S.2d. 266 (1949) and Application of Rutherford Estates, 95 N.Y.S.2d. 658 (1950). (The tenants unsuccessfully argued that the landlord must pay these and any other expenses from net income based upon a fair and reasonable rental value.)

[27]In Application of Frankel, 56 N.Y.S.2d. 316 (1945), the case was remanded because the trial judge failed to indicate just what allowances he made for the landlord's operating and maintenance expenses.

[28]See e.g., Application of Frankel, 56 N.Y.S.2d. 316 (1945); Application of Stabler, 89 N.Y.S.2d. 205 (1949); Application of Broaduane Corporation, 137 N.Y.S.2d. 112 (1952); Application of 1359 Broadway Associates, 134 N.Y.S.2d. 235 (1954); In re Trustees of Masonic Hall, 154 N.Y.S.2d. 937 (1956); and Application of Underhill, 171 N.Y.S.2d. 215 (1958.

If maintenance costs actually constituted capital improvements, the courts reserved the right to take into account their probable life and pro-rate these costs, since the statutes made no specific provision for capital improvements.[29] The value of capital improvements could also be added to the assessed value in determining value.[30]

The statutes made no specific provision for depreciation, which landlords claimed should be considered an operating expense. In In re Fifth Madison Corporation,[31] the Court of Appeals held that the statutory fair return formula for operating and maintenance costs was limited to actual costs. Since depreciation was a theoretical cost, landlords were not entitled to any reimbursement for it unless they could prove actual depreciation.

In several cases, the courts did take the actual physical condition of the building into account. The statutes allowed the courts to consider "the kind, quality and quantity of services furnished."[32] This usually resulted in a reduction in the rate of return below the statutory standard.[33]

In determining a fair and reasonable rent, the courts noted:

> ...that no additional burden or expense chargeable to the maintenance [of the building] will be cast upon the tenants of the business space for any seeming inadequacy of the rent.[34]

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[29]See e.g. Schack v. Handel, 62 N.Y.S.2d. 407 (1946).

[30]See In re Trustees of Masonic Hall, 154 N.Y.S.2d. 937 (1946).

[31]297 N.Y. 155, 77 N.E.2d. 134 (1948) (without the inclusion of depreciation, the landlord only received a 5.23%, instead of the statutory 6%, return).

[32]McKinney's Unconsolidated Laws, Sections 8524(1) and 8554(1).

[33]See e.g. Application of Murphy, 104 N.Y.S.2d. 500 (1951) (the building was 60 years old, unheated, rundown, and rat-infested) and Application of Broaduane Corporation, 137 N.Y.S. 2d. 112 (1952) (a very old and neglected building).

[34]Application of Sewdon Realty Corporation, 31 N.Y.S.2d. 427 (1948) at 431.

The statute required that landlords, in applying for rent increases, provide income and expense information. Some courts limited their consideration to the data, which usually covered the preceding year, as of the date of the filing of the landlord's application, while others considered post-filing changes in income and expenses.[35]

Income was considered to be the landlord's actual income attributable to the space occupied by commercial tenants.[36]

Fair Market Value

Whether the assessed value represented the fair market value was often disputed by landlords. This was a rebuttable presumption.[37]

The courts rejected the argument that mortgage indebtedness should be added to assessed value since separate provision was made for amortization of mortgages.[38]

They did, however, allow consideration of the improvements (i.e., the building) where value was in dispute.[39] As previously indicated, consideration was given, where appropriate, to the physical condition of the building.[40]

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[35]See e.g. Application of Alibel Corporation, 136 N.Y.S. 2d. 344 (1954) (which reviews the case law on this point).

[36]See Court Square Building v. City of New York, 298 N.Y. 380, 83 N.E.2d. 843 (1949). Income from residential tenants must be separated. See e.g. Application of Birrell, 175, N.Y.S. 2d. 449 (1958).

[37]See Application of Rector, 119 N.Y.S.2d. 425 (1953) (presumption was not rebutted).

[38]See Sancer Realty Corporation v. Machlowitz, 85 N.Y.S.2d. 491 (1946).

[39]See Application of Moises Cosio Corp., 128 N.Y.S.2d. 440 (1954) (improvement was not inadequate to justify 6% rate of return) and Mid-Madison Corp. v. Borgansky, 117 N.Y.S.2d. 451 (1952) (8% rate of return justified without highest economic use of land).

[40]See also 160 Fifth Avenue Corporation v. Raymond Service, 82 N.Y.S.2d. 846 (1948).

Generally, the most recent assessed value was the basis for determining fair return.[41] The fact that the landlord had applied for a tax assessment reduction was not considered conclusive as to the actual value.[42] In In re Trustees of Masonic Hall,[43] the Court of Appeals held that a tax-exempt landlord's tax savings should be considered as imputed income, rather than being added to assessed value.

Apportionment of Rent Increases

In Relmar Operating Corporation v. Roffer,[44] the Court of Appeals held that a commercial landlord was only entitled to a fair return from the entire property, not from each and every tenant.

However, the courts, as authorized by the statutes, did apportion allowable rent increases based upon the tenants' pro-rata occupancy and the fair rents which they determined.[45]

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[41]The use of a prior figure was disfavored. See, e.g. Application of Lamon, 96 N.Y.S.2d. 379 (1950) and Application of 104 Bleecker Street, 131 N.Y.S.2d. 408 (1954).

[42]See e.g. Application of Broadwane Corporation, 137 N.Y.S. 2d. 112 (1952) and Application of No. 1 West 39th Street Corporation, 178 N.Y.S.2d. 141 (1958).

[43]154 N.Y.S.2d. 937 (1956).

[44]297 N.Y. 609, 75 N.E.2d. 626 (1947), and Application of Savada, 95 N.Y.S.2d. 650 (1949).

[45]See e.g. Court Square Building v. City of New York, 77 N.Y.S.2d. 847 (1948); Schack v. Handel, 62, N.Y.S.2d. 407 (1946); Cedar-Temple Realty Corporation v. Astor, 93 N.Y.S.2d. 259 (1949); 792 Madison Avenue v. Virag, 100 N.Y.S.2d. 179 (1950); and Application of Flatto, 108 N.Y.S.2d. 385 (1951).

CONCLUSION

First, the New York courts consistently upheld the constitutionality of New York City's commercial rent control based upon New York's legitimate use of the police power to deal with this problem.

Second, in view of the analysis of the disadvantages of the fair return on value formula in the companion memo, the use of this formula based upon assessed value is inappropriate in Elmwood. This is especially true because of the distortions in assessed value caused by Proposition 13.

Third, the assessed value fair return formula is not generally used in residential rent control. Where it has been adopted, it has been subjected to severe criticism by the courts, in part because of the shortcomings of the assessment system. However, in New York its use for both residential and commercial rent control was ruled constitutional.

Finally, even though New York City's fair return formula is not necessarily adaptable, its interpretation by the courts is instructive. In particular, they addressed such issues as the relevance of the condition of the building, the treatment of capital improvements and depreciation, and the imposition of annual ceilings on allowable rent adjustments.

City of Berkeley

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September 23, 1982

To: Board of Adjustments

From: NATALIE E. WEST, City Attorney

Subject: ADOPTION OF REGULATIONS IMPLEMENTING THE ELMWOOD COMMERCIAL RENT STABILIZATION AND EVICTION PROTECTION ORDINANCE ("MEASURE I") AS REVISED AFTER PUBLIC COMMENT

I. PURPOSE OF BOARD OF ADJUSTMENTS SPECIAL MEETING

The special meeting of the Board of Adjustments set for September 29, 1982 has been called to adopt regulations implementating Measure I. Two sets of proposed regulations were issued on August 9, and 23, 1982, respectively, and written public comments were solicited. The regulations attached to this memorandum, (Exhibit "F") have been revised in light of public comment and new concerns which came to light in the course of drafting both the regulations and various forms. These are discussed in another section, below.

II. BACKGROUND

Under Measure I the Board of Adjustments is charged with developing regulations which establish procedures for resolving disputes concerning the application of the ordinance and standards to apply in resolving these disputes. These disputes can be said to faill into two major categories which are briefly described below:

(A) Maintenance of Net Operating Income (or "MNOI") Disputes. In essence the ordinance follows an approach which allows a landlord to maintain his or her net operating income in the base rent period. In other words, a landlord may raise rent only if, and to the extent, his or her costs go up since the end of the period used for calculating base rent. These increases in periodic costs are called "allowable adjustments". The manner of calculating base rent will vary based on the type of landlord tenant relationship. In the case of a lease entered into on January 1, 1981 which expires on December 1, 1982, the base rent will be the last rent authorized by that lease and increases in rent after December 1, 1982 will have to be based on increases in periodic costs incurred after that date. A more detailed description of the application of the ordinance to leases is set out in another section of this memorandum.

(B) Disputes Over Whether The Landlord Is Receiving A Reasonable Rate of Return.

The ordinance also requires the Board of Adjustments to issue regulations which permit a landlord to obtain an "extraordinary rent increase" if the MNOI approach does not result in giving him or her a constitutionally sufficient "fair and reasonable rate of return on investment." One major difference between "extraordinary rent increases" and "allowable adjustments" is that the landlord must seek the permission of the Board prior to imposing the former. In the latter case, the ordinance relies on the ability of the tenant to challenge a particular increase by virtue of detailed notice to ensure that the rent levels charged are legally permissible.

Developing regulations in the area of fair and reasonable rate of return is a difficult and lengthy process. Thus, it was determined by the Board of Adjustments' sub-committee on Measure I that regulations in the area of MNOI disputes should not await development of regulations on fair and reasonable rate of return. Thus, the regulations submitted for adoption by the Board related only to disputes in area (A) above.

III. THE APPLICATION OF THE ORDINANCE TO LEASES

The ordinance treats leases in three different ways based upon when the leases were executed. Rents under leases executed most recently are subject to the most stringent regulation. This application is illustrated graphically below.

Today June 8 (passage and effective date of ordinance) October 2, 1981	Leases executed during this period are subject to the ordinance, i.e. the rent charged cannot exceed the base rent plus allowable adjustments.
October 1, 1981 October 2, 1980	Leases executed during this period are only subject to CPI cap on the rents authorized by the lease.
October 1, 1980 Year 1	Leases executed during this period do not have their rents regulated by the ordinance until the lease expires or until any renewal lease expires, if the parties have a right to renew.

(The graph moves forward through time as you go up vertically.

IV. THE PROCESS OF ISSUING REGULATIONS.

The regulations submitted for final adoption were developed in the following manner:

Step 1: A draft developed by staff was submitted to the Board of Adjustments Sub-Committee on Measure I ("Sub-Committee").

Step 2: The draft as revised after comments by the Sub-Committee was submitted to the Board of Adjustments ("Board") for issuance as proposed regulations.

Step 3: The Board issues proposed regulations and invites written public comment within two weeks. The public is notified by publication and by postcards.

Step 4: The staff revisions of the regulations are submitted to the Sub-Committee along with a copy of the written public comments received.

Step 5: The regulations as revised after comments by the Sub-Committee are submitted to Board for final adoption at public hearing. The public is notified by publication and postcard of the time and place of the hearing and of the fact that the copies of the staff report will be available at city offices, the main library and the Claremont branch library.

V. THE REVISED REGULATIONS

An analysis of the public comments received and the extent to which these comments were incorporated is attached to this memorandum as "Exhibit E". The copy of the comments received are attached as Exhibits "B" (letter from Walter Wright dated 8/23/82 in response to issuance of proposed regulations 400, 571, 572, and 573) and "D" (letter from Walter Wright and Harold Brandel dated 9/7/82 in response to issuance of remaining proposed regulations on 8/23/82). The letter from Manuela Scott dated 8/25/82 responding to Mr. Wright's letter of 8/23/82 is attached as Exhibit "C".

In addition to the changes described in the Analysis, (Exhibit "E") the other two major changes in the regulations are that the notices prescribed by the regulations are required to be given on the forms supplied by the Board which are far more detailed than the ones originally proposed. The rationale for this change was two-fold. Firstly, the Ordinance relies on a tenant to challenge illegal rent levels and thus, for the most part, it will be the tenant who petitions the Board for a hearing. In order for the issues at the hearing to be clearly defined, it is essential that the tenant receive adequate information in order to determine whether the rent charged is legally permissible. Secondly, since some the provisions of the ordinance are complex, the forms serve the purpose of assisting a landlord in determining whether the rent levels he or she proposes to charge are permissible.

The other major change is to provide for an administrative order of rent roll-back in order to ensure that tenants who rely on Board regulations are not subjected to eviction for non-payment of rent.

V. RECOMMENDATION

It is recommended that the Board adopt the attached resolution (Exhibit "A") which would:

(a) Adopt the attached regulations.

(b) Set a petition filing fee of $100 for the first unit, and $20.00 for each additional unit in the same building which will be reviewed at the end of six months.

(c) Authorize the staff to make any changes in the forms attached which in their judgment are appropriate.

NATALIE E. WEST
City Attorney

By Manuela Scott
MANUELA SCOTT
Deputy City Attorney

Attachments